COURSEWARE

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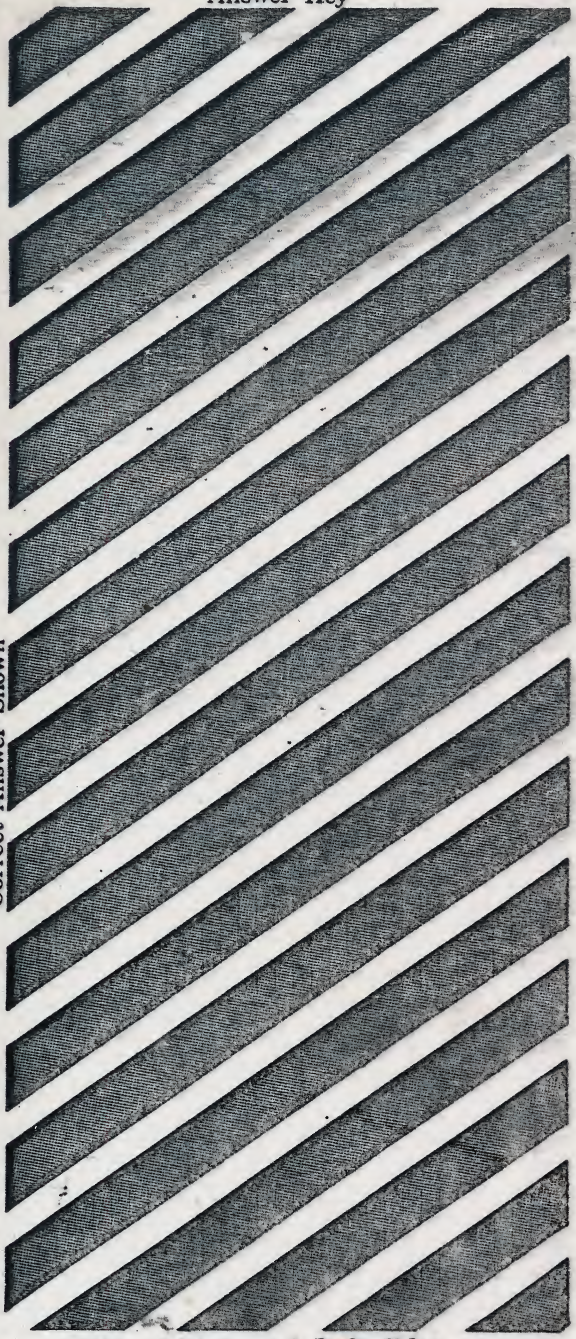
Answer Key

Correct Answer Shown



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1. What term refers to the recording of transactions?
   - summarizing
   - bookkeeping
   - dispersing
   - auditing
2. How does a CPA receive his license?
   - by military promotion
   - by passing a rigorous test
   - by primogeniture
3. What is the term for the accounting step of grouping similar entries together for review?
   - classifying
   - tabulating
   - recommending
   - discarding
4. What is affected by profit or loss from operations?
   - petty cash fund
   - vacation time
   - equity
5. A change in assets is usually accompanied by a corresponding change in what?
   - benefits
   - liabilities
   - workmen's compensation
   - classifying
6. What two accounts are affected when equipment is purchased on credit?
   - sales tax payable
   - equipment and accounts payable
   - insurance expense and equipment
7. What is the first stage of accounting?
   - setting up of expense account
   - purchase of postage stamps
   - recording of transactions

1. What is one advantage of double entry accounting?
   - ◯ it is a relatively new method
   - ◯ if one aspect of transaction is entered incorrectly, other part will show up error
   - ◯ it requires little or no bookkeeping
2. When debiting an account where is the entry written?
   - ◯ left side
   - ◯ bottom line
   - ◯ right side
3. What does a credit entry do to an asset account?
   - ◯ closes the account
   - ◯ increases it
   - ◯ decreases it
4. What is provided by the sale of merchandise or services?
   - ◯ revenue
   - ◯ journal accuracy
   - ◯ imbalance
   - ◯ incorporating
5. What kind of error occurs when digits within a figure are reversed?
   - ◯ magnetic
   - ◯ transposition
   - ◯ reference
   - ◯ inventory
6. What account, like liabilities, increases with credit entries and decreases with debit entries?
   - ◯ petty cash
   - ◯ supplies
   - ◯ equity
   - ◯ merchandise inventory
7. What is the collective name for stubs, receipts, tickets and invoices?
   - ◯ business papers
   - ◯ credit purchases
   - ◯ posting reference

1. What provides data for periodic reports?
   - carbon copies
   - timecard
   - net balances of ledger accounts
2. What serves as a check to assure total debits and credits are equal?
   - trial balance
   - dividends
   - original entry
   - invested capital
3. Which two financial statements reveal operations and conditions?
   - income statement and balance sheet
   - trial balance and liability accounts
   - journal and invoices
4. What is listed under "Total Liabilities" on the balance sheet?
   - total sales
   - preliminary reports
   - equity
5. Where does the transaction go after business papers and journal?
   - depreciation expense
   - general ledger
   - invoice
   - circular file
6. What is a single written record of a single transaction called?
   - disbursement
   - entry
   - equity
7. What can be considered a subject classified file?
   - inventory
   - business papers
   - account in ledger
   - footing

1. Who sees the work sheet besides an accountant?
   - ◯ the general public
   - ◯ usually no one
   - ◯ assembly line workers
2. What is the third pair of columns on the work sheet?
   - ◯ merchandise inventory
   - ◯ gross margin
   - ◯ adjusted trial balance
3. If equipment costing $5000 is depreciated over 50 months, what is the monthly rate?
   - ◯ $500 per month
   - ◯ $100 per month
   - ◯ $10 per month
4. What is the reasonable result if, during a period, assets increased more than liabilities?
   - ◯ a profit was earned
   - ◯ company breaks even
   - ◯ the company goes bankrupt
5. What would be recorded as a debit in the Income Statement and a credit in the Balance Sheet columns?
   - ◯ loss
   - ◯ inventory
   - ◯ profit
   - ◯ petty cash
6. What is another name for statement of operations?
   - ◯ owner's equity
   - ◯ balance sheet
   - ◯ income statement
7. What is located at the "bottom line?"
   - ◯ income or profit
   - ◯ personal references
   - ◯ chart of accounts

1. What account might utility deposit, advance rent, and insurance premiums be entered into?
   - ◯ Advertising Expense
   - ◯ Interest Expense
   - ◯ Prepaid Expense
2. If advance payments are merely charged as an expense when paid, rather than first recorded as assets, what type of basis is this?
   - ◯ cash basis
   - ◯ accrual basis
   - ◯ credit basis
3. What type of book might sales and returns be recorded in?
   - ◯ purchases journal
   - ◯ sales journal
   - ◯ combined cash journal
4. If expenses and cost of goods sold are subtracted from revenues, what is left?
   - ◯ profit
   - ◯ salaries paid
   - ◯ sales returns
5. What report refers to the accounting period?
   - ◯ Balance Sheet
   - ◯ Income Statement
   - ◯ trial balance
6. What might a company owner do rather than receive a monthly salary?
   - ◯ set up a drawing account
   - ◯ cash in recently purchased stocks
7. What is the title of the work sheet containing a list of the accounts and their net balances?
   - ◯ income statement
   - ◯ trial balance
   - ◯ financial statement

1. What are the two ways of accounting for revenue?
   - income basis and deferred basis
   - cash basis and accrual basis
2. Why is cash basis accounting usually explained first?
   - it is more likely to be used by a manufacturer
   - it is the least complex method
3. What kind of accounts are salaries and taxes payable?
   - assets
   - liabilities
   - equity
4. What is the cost related to the continually reduced value of an asset?
   - depreciation
   - credit value
   - bad debts
5. Besides cash and salary expenses, what two accounts are effected by the issuing of payroll checks?
   - sales expense and bad debts expense
   - FICA taxes payable and employee's withheld income tax payable
6. When should the journal be proofed?
   - end of accounting period
   - close of work day
7. A trial balance of the ledger accounts is prepared after what is completed?
   - depreciation
   - posting
   - inventory

1. At what point is revenue considered earned in accrual accounting?
   - ◯ at end of the fiscal year
   - ◯ when goods and services sold and delivered
   - ◯ only when cash is actually received
2. What accounting step is taken when some person fails to pay his account?
   - ◯ amount taken from cash account to cover
   - ◯ unpaid account
   - ◯ written off into account "Bad Debt Expense"
3. Which method of depreciation is the simplest?
   - ◯ constant amount (straight-line)
   - ◯ declining balance
   - ◯ sum-of-the-digits
4. What is a trade discount?
   - ◯ difference between wholesale and retail prices
   - ◯ seasonal reduction in price of stock
5. What might cause a supplier's account to have a debit balance?
   - ◯ end-of-period adjustment
   - ◯ the supplier was overpaid
6. What effect has sales on Accounts Receivable?
   - ◯ it is decreased
   - ◯ it is increased
   - ◯ no effect
7. What is a disadvantage of restricted check handling?
   - ◯ poor security
   - ◯ tends to permit undetected errors

1. What are referred to collectively as "cash items?"
   - small bills only
   - checks, money orders or drafts
   - promissory notes
2. Under what circumstances would the debit total of the cash account not exceed the credit total?
   - no money in the bank account
   - excess money was paid out as dividends
3. What is one reason for the separation of the functions of handling cash and keeping records?
   - less paper work required
   - reduces errors
   - handled in different departments
4. What is a disbursement?
   - bulk mail
   - the promoting of a product
   - cash payment
5. What is done when petty cash is nearly all disbursed?
   - account is proved and check written
   - account is closed
6. What speeds the processing of checks?
   - magnetic character recognition
   - manual labor
   - satellite conveyance
7. What may be done if cause of cash shortage or overage cannot be found?
   - accountant is fired
   - an entry to "cash short and over"

1. Which word is used to refer to labor compensation for hourly labor?
   - salary
   - wage
   - fee
2. Which law covers overtime?
   - Overtime and Vacation Law
   - Federal Wages and Hours Law
   - Business Rules and Regulations
3. What is form SS-5?
   - hospitalization insurance
   - notice of retirement
   - application for social security number
4. What is attached to each payroll check?
   - earning and deductions statement
   - a monthly W-2 form
5. At what time must W-2 forms be furnished?
   - by January 31
   - end of June
   - every five years
6. How is an expense account increased?
   - by debiting
   - by crediting
7. What is form 941 used for?
   - promotion application
   - quarterly tax returns
8. What document is signed by the supervisor before paycheck is issued?
   - stock certificate
   - ivoice
   - time card
   - legislative bill

1. What remains after expenses and purchase costs are subtracted from total sales?
   - ◯ inventory
   - ◯ profit or loss
2. How is gross margin determined?
   - ◯ by sum-of-the-digits method
   - ◯ sales minus cost of goods sold
3. What usually accompanies the arrival of goods?
   - ◯ payroll
   - ◯ cash refund
   - ◯ delivery slip
4. What type of account is Accounts Payable?
   - ◯ liability
   - ◯ equity
   - ◯ asset
5. Define "summary posting?"
   - ◯ early package mailing
   - ◯ single monthly posting
6. What is the net debit balance of "Accounts Receivable?"
   - ◯ amount paid in state taxes
   - ◯ total amount receivable from customers
7. In what order are credit sales listed in the Sales Journal?
   - ◯ chronologically
   - ◯ in order of increasing amounts

1. What is the counterpart of a note receivable?
   - accrued interest
   - note payable
   - discount amount
2. What units of time are interest rates usually given in?
   - weekly rates
   - monthly rates
   - yearly rates
3. What is gained by "discounting" a note to the bank?
   - unlimited credit
   - increase in inventory
   - quick cash
4. What do you get when interest is added to the principal of a note?
   - maturity value
   - revenue and expense
   - contingent liability
5. What is left after discount is subtracted from maturity value?
   - principal
   - cash deposit
   - proceeds
   - interest
6. What occurs when proceeds are greater than principal?
   - interest revenue
   - monetary loss
7. What is sometimes issued by a customer to extend the period for payment of an account?
   - stock certificate
   - promissory note

1. Which of the following is generally paid for before its sale or use?
   - taxes payable
   - salaries
   - inventory
2. How many times a year is inventory taken?
   - once or twice
   - six
   - twelve
3. What is "costing?"
   - total expenses in a fiscal year
   - assigning a price to goods
4. Which method of costing is more traditional and more representative of the facts?
   - lifo
   - fifo
5. What rule anticipates losses but not gains?
   - fiscal rule
   - conservative rule
6. What method of inventory records additions and reductions as a result of purchases and sales?
   - "left over" inventory
   - perpetual inventory
7. What are the "asset" and "expenses" methods used in determining?
   - prepayment accounting
   - inventory costing

1. What is another name for "plant" or "capital" assets?
   - short term
   - fixed
   - current
2. Where did the term "real" as referring to property come from?
   - "royal", king owned land rights
   - it distinguishes from intangible assets
3. What type of assets are patents, copyrights and leases?
   - tangible
   - intangible
4. What type of assets are often classified as "wasting assets?"
   - land, buildings and equipment
   - patents, copyrights and leases
   - oil, gas, ore and timber
5. What might be separately classified as "investments?"
   - land, buildings and equipment
   - stocks and bonds
   - "goodwill"
6. What asset would usually be written off in 20 to 40 years?
   - inventory
   - building
   - land
7. What is the calculation of unit output useful in determining?
   - intangible assets
   - organization costs
   - depreciation

1. Is a proprietorship or a corporation usually larger?
   - proprietorship
   - both same general size
   - corporation
2. What is a disadvantage of a proprietorship?
   - capital and credit may be limited
   - difficult to organize
   - requires large amount of government reports
3. What is an advantage of a partnership?
   - decreased personal risk
   - ownership in firm is easily transferred
   - greater credit available
4. Which business form is subject to double taxation?
   - proprietorship
   - partnership
   - corporation
5. What event might end a partnership?
   - death or retirement of partner
   - a new century
   - end of fiscal year.
6. Which state has the most convenient provisions for corporations?
   - California
   - Rhode Island
   - Delaware
   - Mississippi
7. What is the meaning of the term "by proxy"?
   - limited partnership
   - parcel post
   - written permission
   - original charter
8. What is a stated nominal value for shares called?
   - equity
   - par value
   - a potential liability
   - revenue

1. Who will want to see yearend reports, plus interim reports?
   - newspapers and magazines
   - government and credit agencies
2. Which account normally require no yearend adjustments?
   - Inventory, Supplies, Purchases
   - Cash, Equipment, Investments
   - Accumulated Depreciation
3. The Adjusted Trial Balance is derived from what other columns?
   - Miscellaneous, Prepaid Expenses
   - Accumulated Depreciation, Equity
   - Trial Balances, Adjustments
4. What is the payment of earnings of a corporation to shareholders called?
   - dividends
   - bribes
   - taxes
5. What does a "closing " entry do?
   - freeze asset account
   - close out balance in account
   - close down the business
6. What is done to an account to mark the end of the fiscal year?
   - balancing and ruling
   - totaled and written off
   - edited and removed
7. What is the process of recording, adjusting, closing, documenting and reporting of financial data called?
   - bookkeeper's rounds
   - accounting cycle

1. What is another term for an automatic accounting system?
   - ◯ MICR
   - ◯ data-processing system
2. What is the purpose of two people making the same entry into a computer system?
   - ◯ extra accuracy
   - ◯ two people needed to feed computer
3. What does the term "manual alpha-numeric" refer to?
   - ◯ computer keyboard
   - ◯ software
   - ◯ sanskrit
4. What might be used for temporary storage of memory?
   - ◯ cathode ray tube
   - ◯ magnetic cores and intergrated circuits
5. Are "displays" permanent records?
   - ◯ yes ◯ no
6. What is a collective name for magnetic tapes and discs?
   - ◯ verification
   - ◯ software
   - ◯ invoices
7. What are some reasons for using a computer accounting system?
   - ◯ time and labor saving
   - ◯ reduced cost; error proof

Assets, Liabilities, and Equity

1. In these programs you will learn about procedures which are applicable to a wide variety of organizations, including proprietorships, corporations, associations and independent divisions. Since most accounting is performed for profit-seeking persons or companies, much of the discussion will be presented from their viewpoint, but most of the procedures you learn about will apply to other organizations.

2. Accounting is an activity which records and presents the results of financial transactions. An accountant also helps interpret these results. Bookkeeping refers to the appropriate recording of transactions, whereas accounting also includes the professional aspects of the design of records, analysis and interpretation of data and reports, and policy recommendations. What organization do you think most accountants work with? (profit-seeking individuals and firms) (non-profit associations)

3. Yes. Bookkeeping means the recording of transactions, while accounting includes professional review. What does an accountant do? (record, tabulate, calculate only) (analyze, interpret, record, design, recommend)

4. Right. In addition to the owners, directors and manager of an organization, banks and other creditors such as suppliers depend on the reports which are prepared by a capable accountant. And increasingly, government agencies, at local, state and national levels are requiring information obtained by accounting methods.

5. Accounting is the "language of business". It communicates important facts about an organization to those who need to know. Accountants may work in public, private or government accounting. A "Certified Public Accountant" (CPA) is one who receives a license by passing a very rigorous test in accounting theory, accounting practice, auditing and business law prepared by the American Institute of Certified Public Accountants. Public Accountants may be required to obtain a license to practice accounting. Who need to know accounting facts about an organization? (the treasurer) (owners, managers, creditors, government) (general public, employees, competitors, newspapers)

6. One of the major activities of accountants is "auditing", which is checking the financial records of an organization with certain tests for accuracy. The accountant also performs certain management advisory services for which their training and experience has qualified them.

7. The first stage of accounting is the recording of transactions such as sales, purchases, loans or receipts for money, all of which is normally done by a bookkeeper. It may be by hand in a record book, but today it is often performed by keyboard into a "bookkeeping system", or by making a recording on a punched card, a paper tape, a magnetic tape or otherwise, so that a computer may process the entry.

8. Another accounting step is classifying, or grouping similar entries together for convenient review. Summarizing is a function which brings various pieces of information together for study. Before classifying and summarizing, what is the first step of accounting? (auditing) (recording) (playback)

9. Yes. When a financial transaction occurs, like the purchase of some supplies for cash, it must be recorded. Periodically such recorded accounting entries are grouped for review. This is "classifying". What do we call the step which brings accounting information together for study? (summarizing) (dispersing) (dividing)

10. Yes. The "assets" of a firm are those things of value owned by the firm. These include cash, merchandise, furniture, machinery, buildings, land, accounts receivable and notes receivable. "Accounts receivable" are amounts owed by customers and others without written formal promises to pay, and "notes receivable" are the sums owed to the organization represented by written promises with specified dates and amounts.

11. Some usual kinds of assets are: money, inventory, automobiles, real estate and money owned by others to the organization, called "accounts receivable". What is an asset called when money owed to the firm by others is shown by written promises? (accounts overdue) (notes unable) (notes receivable)

12. Right. "Liabilities" are the obligations or debts of an organization or person payable to others. The most common kinds of liabilities are accounts payable, notes payable, taxes payable, and salaries payable. "Accounts payable" are debts, normally to suppliers, which are not represented by specific promises and due dates. "Notes payable" are written and signed promises to pay a stated amount on a specific date.

13. Remember, accounts payable are owed without a written promise to pay. What do you call a debt with a written and signed promise to pay on a specific date? (account due) (notable account) (notes payable)

14. There are three elements of accounting: assets, liabilities and equity. If it is to operate properly, an organization should have more total assets than total liabilities. The differences between these totals is called the "equity" of the owners. If the assets total $100,000 and the liabilities are $60,000, the equity is $40,000. Sometimes the terms "net worth" or "capital" are also used to mean the owner's equity. What are the "three elements of accounting"? (assets, liabilities, equity) (furniture, fixtures, fittings) (capital, labor, interest)

15. Yes. Accounts Payable and Notes Payable are liabilities. They are debts which must be paid. What are Accounts Receivable and Notes Receivable? (assets) (liabilities) (capital)

16. Yes. Since equity is the difference between assets and liabilities, another way of saying

this is that total assets equal total liabilities plus total equity. If total assets are $100,000, the liabilities may be $60,000 and equity $40,000. Also if the total of all liabilities and all equity is $100,000, then all assets equal $100,000. These are different ways of expressing what is called the "accounting equation".

17. From a logical point of view, however, since owner's equity after a period of operations is just whatever is left over after subtracting liabilities from assets, the equation may be written "assets minus liabilities equal equity". But it is customary to show assets on one side, with liabilities and equity on the other side of a report.

18. Two forms of the accounting equation are shown here: assets minus liabilities equals owner's equity, and assets minus equity equals liabilities. What is another form of the equation? ($\frac{\text{assets}}{\text{liabilities}}$ = equity) (assets = liabilities + equity)

19. Right. Assets and liabilities change frequently, when supplies are purchased or expenses incurred. But there are only two ways that owner's equity can change: First, from changes in the total investment such as paying in some capital, or withdrawal (if corporation dividend); and secondly, from operations which result in profit or loss. In each case there will be a change in the assets, or liabilities, or both, since there must be a change in the difference between them which is the equity.

20. Capital, or equity, can change in two ways. One is by profit or loss from operations. What is the other? (increased sales) (decreased sales) (owner investment or withdrawal)

21. Right. A "transaction" is an activity of the company which involves some change in its assets, liabilities or equity, expressed in financial terms. Buying equipment or materials, paying a creditor, selling goods or services or receiving payments are typical transactions, which can be small or quite large.

22. A transaction may affect, one, two, or all three of the accounting elements. This could occur when the asset "cash" is paid for the asset "merchandise" at the time of purchase. More often it affects both liablilities and assets, such as inventory and accounts payable. If you sold an asset which was shown as worth $100 in inventory, and you received $200 cash for it, there would be changes in two asset accounts and one more change. What other main element of accounting do you think would be changed? (liabilities) (owner's equity (a profit))

23. Right. Now let's start up a company. If General Energy Devices was incorporated, and $10,000 cash was invested by its shareholders, it would have assets of $10,00 in cash, no liabilities, and invested capital of $10,000 shown as owner's equity. Why aren't there any liabilities? (GED doesn't owe anyone) (The liabilities exceed the accounts) (The company is profitable)

24. Yes. The transaction of establishing General Energy Devices by depositing $10,000 in the bank and issuing $10,000 worth of capital shares to the owners does not yet involve any debt. Later equity investment by owners is a similar non-liability transaction.

25. When transactions are recorded, the odd cents are entered. In many periodic financial reports, for simplicity and convenience, only even dollars are shown.

26. GED now buys $1200 worth of equipment on an open account, payable in 30 days. In this transaction, there is no change in cash or equity, but there is an increase in assets and an increase in liabilities of an equal amount. The asset account called "equipment" is increased $1200, and the liability "accounts payable" is increased by the same amount.

27. The company now has $10,000 cash, $1200 of equipment, $1200 of accounts payable and $10,000 of equity capital. This was the result of two transactions. What kind were they? (+ assets, + equity ($10,000) + asset, + liability ($1200)) (- asset, - asset ($10,000) + liability, - equity ($1200))

28. Yes. Another kind of transaction can increase one asset account and decrease another. For example, if the company bought $500 worth of supplies for cash, the asset account "supplies" would be increased by $500 and cash decreased by $500.

29. When an organization purchases with cash, something which is kept as an asset, is there a change in liability or in equity? (yes, in accounts payable) (no)

30. Right. But a change is an asset is usually accompanied by a corresponding change in liabilities. For example, GED company may pay $600 for equipment already purchased and recorded in Accounts Payable. This would decrease cash by $600 and decrease accounts payable by $600.

31. You have now seen four examples of the numerous kinds of transactions: an investment, which increases assets and equity, a credit purchase, which increases assets and liabilities, a cash purchase, which increases one asset and decreases another, and a payment, which decreases an asset, and decreases liabilities. Do you think there could be a transaction other than investment which would affect two kinds of assets and equity? (Yes, sell an asset at a profit) (No, it could never happen)

32. Yes, the firm could sell something for more or less than the amount listed on the asset accounts, and the profit or loss would change the equity. Another transaction might be the sales of services for cash, at which time the salary of the employee who performed them might be set up as a liability, and the difference, if any, would be a profit or loss adjustment to equity.

33. Some kinds of transactions are entered periodically. This is done for convenience as it would be too costly and time-consuming to put the cost of one hour's work by an employee, one postage stamp or one telephone call. Individual sales of major assets can be offset by

reduction of an asset, but sales of services are usually accumulated and offset by salaries paid during an accounting period.

34. In the same way, expenses are accumulated, and when a statement for expense is received and entered into the account, the equity is reduced unless there is a specific offsetting increase in assets. At the end of the first week of business, we will say that GED Incorporated, has $8900 in the bank, $500 worth of supplies, $1200 worth of equipment, and $400 accounts receivable for services which were sold. Total assets, $11,000.

35. Liabilities are $600 in accounts payable owed for equipment and $250 owed for employees' salaries, and $50 for other accrued expenses. Equity is $10,000 of capital plus $100 of earnings. What is the total of liabilities and equity? ($10,600) ($11,000, the same as total assets; to satisfy the accounting equation) ($10,900)

36. Right. Here is the statement. It is called a balance sheet. It shows the condition of the company at a certain time, and is sometimes called the statement of condition. As you can see, the total assets equal the total liabilities and equity. If they didn't balance, we could assume the assets and liabilities are shown correctly, and a profit or loss was incurred. We would then adjust equity for this amount making both sides balance. What item of equity would probably be changed? (earning (profit or loss)) (cash)

37. Yes. Another periodic statement is the Income Statement, also called the Profit and Loss or Operating Statement. Here you see that in the first week of operation, only $400 of sales were made for services. The expenses shown are for salary expense, and other expenses. For any real organization there would be at least 20 or 30 expenses; for rent, telephone and other utilities, depreciation, overhead expenses including legal and auditory expenses accrued, various taxes including unemployment, Social Security, and income, several kinds of insurance including workmen's compensation and public liability, licenses, fees, transportation, employees' benefits and reserves for a number of other expenses to be accrued. For the moment, these are merely included in accrual accounts.

38. You should remember that the Income Statement refers to a period of time, while the balance sheet refers to a point in time. The Balance Sheet might be dated "as of December 31, 1976", or "as of June 30, 1977" but the Income Statement would state "for the week ending September 15", or "for the month ending November 30" or "for the year ending December 31, 1977".

39. By accounting, you can record financial transactions and present these results. These results may be presented to the owners, managers, creditors and government. The steps include recording, classifying and summarizing. Transactions are financial events. They are recorded, classified into accounts such as cash, accounts receivable, supplies on hand, inventory and equipment, which are assets, and accounts payable, notes payable and other debts or expenses accrued,

which are liabilities. Retained profits and invested capital make up the owner's equity. Total assets equal total liabilities and equity. What sort of statement shows this equality? (Income Statement) (Balance Sheet)

40. In this program you have learned some of the basic concepts of accounting. They have been presented very rapidly, so you should repeat this program at least once.

Double-Entry Accounting

1. In the first program you saw that for each event, or transaction, which was recorded in a company's accounts, there were two entries. A cash investment in the company increases cash and capital equity. A cash purchase for inventory increases one asset inventory, and decreases another asset, cash. A credit purchase increases an asset, while it also increases a liability, accounts payable. This dual process is called double entry accounting.

2. Double entry accounting systems have been in use for at least 500 years. Their advantages are simplicity, flexibility, accuracy and their tendency to reveal any mistakes. If one aspect of a transaction is overlooked or entered incorrectly, the other part of it will eventually help show up the error, and indicate the correction which is required.

3. A separate record is kept of each kind of asset, such as cash, receivables, inventory, equipment and buildings, and of each liability, such as accounts, taxes and salaries payable. Separate records are also kept for equity. These separate records are called "accounts".... What kind of accounts system requires two entries for each transaction? (dual account) (double entry) (dial system)

4. Yes. Records of accounts may be kept in various forms, including paper and magnetic tape and punched cards. A written account form, like this, has the name and number of the account at the top, lines for each entry, and columns for the date, descriptions, references and amounts of the transactions. The transactions may be divided into two sides, marked "debits", on the left, and "credits", on the right. How would you define an "account"? (a counting of the kinds of forms available) (a separate record of each kind of asset, liability, equity)

5. Right. Some accounts could be cash, inventory, notes receivable, accounts receivable. These would all be asset accounts. Other accounts might be notes payable, accounts payable, taxes and salaries payable. What kind of accounts are these? (liabilities) (equity) (standard balance)

6. Yes. An account form must have a title, like "Cash", a number, like "101", and lines for each entry with columns for date, description of transaction, and references. What other space would be provided? (for possible errors) (for debit and credit amounts)

7. Right. To save space and avoid distracting detail in these programs, "skeleton" or "T" accounts will sometimes be used, showing merely the account title and the total amount of debits and credits being considered at the time. The title will be shown on the top of the T, and the debits and credits below. Which way would you guess the T account is arranged?

(Title) (Title)
debit | credit   credit | debit

8. Yes. You "debit" an account by writing an entry on the left side, and "credit" it by writing the entry on the right. The abbreviation for debit is "Dr" (although there's no "r" in it) and credit, "Cr". On which side are credit entries placed? (left) (top) (right)

9. Right. You remember that in a balance sheet the assets are shown on the left and the liabilities and equity are on the right. You will not be surprised, then, to learn that in asset accounts, a debit entry is considered an increase, and in a liability account, a credit entry is an increase in the account.

10. For the same reason, a credit entry decreases an asset account, and a debit entry decreases a liability or equity account. Remember, total assets equal the total of liabilities and equity. In the same way, total debits equal total credits. Remember, a debit is just a left-side entry, but if you know it is in an asset account, you know it increases the account. What happens when you make a credit entry in a liability account? (account decreases) (account stays same) (account increases)

11. Right. On a balance sheet, the assets are shown at the left. A debit, a left side entry, increases an asset account. A credit entry on the right side column of a liability account, increases it. Where is the equity shown? (on the left, under assets) (on the right, under liabilities (credit increases))

12. Yes. When a company is started, the cash paid in by owners in debited to the asset account "cash" and credited to the equity account, "capital". Here $10,000 is shown paid into capital. What can you say about the accounts? (assets = liabilities + equities, debits = credits) (assets are tied up; no credit is good)

13. Yes. To avoid confusion, you should remember that the word "debit" has nothing to do with "debt", which is what you owe. The word "credit" in accounting is not related to the same word, "credit", meaning financial trustworthiness, or some kind of honor. These terms just mean left-side and right-side on your account sheets.

14. Here are two more T accounts. Some equipment was purchased on credit for $1200. The debit entry in the equipment (asset) account is offset by a $1200 credit entry in the liability account, "accounts payable". Was there a change in equity caused by this transaction? (Yes) (No)

15. Right. As you recall, some transactions just affect two asset accounts. If the company were to buy for cash $500 worth of materials to be kept in inventory, you would debit, (which increases an asset account) the materials account and credit (thus decreasing an asset) the cash account. Was there a change in liabilities or equity caused by this transaction? (Yes) (No)

16. Right. The company then paid $600 on the account payable for the $1200 of equipment it had purchased. The cash account will of course be decreased, which for an asset account means "credited". The "accounts payable" liability account will also be decreased, since the amount still owed is less. To decrease this liability account, what do we do? (debit it) (adjust it) (credit it)

17. The previous transactions, except for the original owner's investment, have not affected the owner's equity. Some other transactions, of course, will affect equity. The sale of merchandise or services will provide revenue, which is money to be received for the goods or services sold. The spending or accrual of debt for some expense such as rent, telephone service, employees' salaries or taxes also affects the owner's equity. How do you think revenue and expense affect equity? (revenue increases equity, expense decreases equity) (revenue decreases equity, expense does not affect equity)

18. Yes. Revenue is not considered by accountants to be the same as income, although many other persons use income to refer to sales or revenue. To avoid confusion you should use the term "income" only when combined with the word "net", and "net income" is the same as "net profit". The inverse of net income is "net loss". Both net income and net loss must be carefully associated with a specific period of operations, such as a month, a quarter, or a "fiscal year". A fiscal year is 12 months, often coinciding with the "calendar year" which ends on December 31, but sometimes ending at some other date.

19. Revenue and expense transactions individually increase and decrease the owner's equity. Ten individual sales of services, for example, may result in total revenue of $1000. During the same period, expenses related to these sales might be $800, $100, or $1200, resulting in net income (or net profit) or $200, or zero, or a net loss of $200. Is revenue the same as net income? (Yes) (No)

20. Right. You may consider the revenue and expense accounts to be temporary sub-accounts of the owner's equity account. Instead of carrying every revenue or expense transaction all of the way to the top of the equity account to show how an individual sale or expenditure would affect equity, they are collected in these revenue and expense equity subaccounts until the end of an accounting period. Besides being less work, what is another reason for this? (Every revenue item has some expenses associated with it which can't always be specified) (No one cares about net income)

21. Yes. The revenue from the sale of something is nearly always associated with some kinds of expenses, even if they are only things like telephone, rent and some employee salary. But it is usually impossible to assign precisely those expenses which apply to any revenue transaction, so revenues and expenses are entered independently for a selected period, then totalled and offsett in an operations report.

22. Total expenses are debits to equity, revenues credit equity. As you have learned, this is because equity, like liabilities, increases with credit entries and decreases with debit entries. Now to maintain our double entry procedure we must enter expenses incurred in the overall expense account as debits, so that their later tranferral to the main equity account can be shown as debits to capital and cancelling credits to expense. How would you describe the revenue and expense accounts? (revenue is an asset, and expense is a loss) (revenue, expense are temporary equity accounts)

23. Right. Remember, debits decrease and credits increase equity balance, and debits increase and credits decrease total expense which is a temporary equity account. The other kind of temporary equity account is revenue. How is revenue affected? (for revenue, debits decrease; credits increase) (for revenue, debits increase; credits decrease)

24. Yes. Transactions are reported verbally, or by business papers like stubs, receipts, tickets or invoices, are often first double-entered into an original entry journal book, then later entered into the accounts, which collectively are called the ledger. If the company provided a service for $100 and billed a customer for it, you would debit accounts receivable and credit revenues $100. If you paid $50 for telephone service what would you do? (debit revenues, credit receivables) (debit expenses, credit cash)

25. Periodically, you can check the accuracy of your accounts by a procedure called the "trial balance." It is a work sheet which is prepared to assure that the debits equal the credits in the ledger, the book of accounts. The trial balance includes all ledger accounts and their balances.

26. First the ledger is a book containing the account sheets. Even though the balances can be shown for each account, the information is difficult to use in this form.

27. The account titles are simply listed in the order they appear in the ledger. If the account has a debit balance, the amount is written in the debit column; if it has a credit balance, the amount is written in the credit column.

28. Notice the heading. This trial balance lists the accounts as they appear in the ledger with their balance. The debit and credit columns each total the same.

29. The trial balnace only proves that the total of debits and credits is equal, but even when the trial balance is in balance, errors may exist. For example, the entries for a purchase of supplies on credit which should have resulted in a debit to supplies and a credit to accounts payable might have credited supplies and debited accounts payable. The debits and credits would be equal, but both supplies and accounts payable would have been understated by twice the amount.

30. Another kind of error occurs when digits within a figure are reversed. This error is called a "transposition". A double transposition is sometimes made. Here 67 has been posted as 76 to both the supplies account and the accounts payable account. Both the debits and credits are equal, but both accounts are overstated by $9. Transpositions tend to create errors which are multiples of 9.

31. Another kind of error occurs when you either miss an entry or fail to post it in any account. Debits and credits are equal, but, both accounts are understated. Will a trial balance indicate a missed entry, double transposition, or wrong account? (Yes, always) (No, not always)

32. Right. When the trial balance does not balance, a single transposition might have occurred

in posting the debit. Total debits would then not equal total credits so the trial balance would be out of balance.

33. Another error occurs when the debit part of the entry is posted, but the credit portion is not. In this case, total credits would be understated and the trial balance will indicate this.

34. Another error is when the debit to supplies is posted as a credit. The result is that debits will be understated and credits overstated. The trial balance will be out of balance. The opposite result will occur, of course, when a credit is posted as a debit. When $10 is posted in the wrong column, what does it do to the account? (makes $5 error in balance) (makes $20 error in balance)

35. There are some tricks for finding errors. Scan the trial balance and ledger accounts for an entry of the amount of the imbalance. If the imbalance is an even number, divide it by two and scan, since certain errors cause an imbalance twice as great as the error. You may have made an error in transferring from the ledger accounts, or in the addition of the columns on the trial balance, so you should check the amounts transferred and check the addition of the trial balance columns.

36. If you haven't found the mistake, add columns and subtract their totals again. Compare the journal entries and the ledger posting to see if you have made any posting errors.

37. Now check every original entry to be sure that the debits posted equal the credits for every transaction. At this point we have gone back through the accounting procedure, and any error that was indicated by the trial balance should have been discovered.

38. If you still can't find it, have another person go through these steps to find the error. In accounting, the person who makes an error tends to make the same error when checking the records.

39. To review, first calculate the amount of error in the trial balance. If it is odd, look for an entry like it. If it is even, divide by two and look for an entry error. Then check the trial balance and original journals. What else could you do? (ask someone to check it) (give up)

40. Journals, ledgers, accounts and trial balances are not formal reports and are not usually presented to management, but they must be accurate. To insure their accuracy, rules and procedures must be followed, and checking methods like the trial balance are used.

The Journal and the Ledger

1. When a company buys supplies, pays rent, pays for freight, buys stamps, or calculates a payroll, there are check stubs, receipts, tickets, invoices, statements, working time cards and the like which are called "business paper" or "immediate records"; but the first formal double-entry record is usually in a book called the "journal". The entry is called "journalizing", which is only done after some person in authority approves the transaction.

2. The journal has columns for the date, a description of the transaction, and debit and credit columns for the amount of money. A posting reference (or folio) column is also provided, for later use. A transaction is recorded in the journal after it is determined what accounts will be affected. Which contains the first formal double-entry record? (ledger of accounts) (journal)

3. Right. Typical journal pages have five columns; for date, description of the transaction, account reference and amount of debit and credit. A journal entry may cryptically say "purchase of typewriter" and note that both equipment assets and accounts payable increased $500. How would this be entered? (Equipment: dr $500, Acc't.Pay.: cr $500) (Acc't. Pay.: dr $500, Equipment: cr $500)

4. An account in the ledger is in effect a subject classified file, or information storage container for one class of financial information. If it were never necessary to examine or report on a selected class of transactions by itself, one might say that the original entry in the journal is nearly all that is necessary.

5. Management does in fact need to know how much cash, or equipment, or receivables, or debts exist or the different kinds of revenues which have been received, or expense which have been incurred. The accounts in the ledger provide the latest detailed information, and the net balances of these accounts provide the data for periodic reports.

6. For example, a company might have, among others, asset accounts 101, 102, 103 and 104 for cash, supplies, inventory, and equipment; liability accounts 201, 202, and 203 for accounts, notes and salaries payable; and equity accounts 301, 302, 401, 402, 501, and 502 for paid-in capital, accrued profits, revenue from sales of services, and inventory and expenses for salaries, rent, and so on. A full list of such accounts is called the "chart of accounts".

7. A small organization would have a small number of accounts; perhaps 10 or 20, and a large company a larger number, if it wished to study its operations in detail. What do you call the list of all the accounts? (Nominal Account Listing) (Mapping of Accounts) (Chart of Accounts)

8. Right. Accounts may be added or eliminated, but this is not done very often. When a transaction occurs, it is entered in the journal by date, noting the account to be debited on one line, and usually the credited account on the next line. (If it is entered into a computer

system, of course you would key in the transaction according to instructions.)

9. If some additional brief comment seems required, it is also copied into the journal at this point. Here is the payment of cash of the capital to start the company.

10. The journal continues with two or three lines devoted to each transaction. In books kept by hand, entries are in longhand. In each double entry, the debits entered equal the credits. Look over each entry carefully. Should the purposes for the transactions and entries be reasonably clear? (Yes) (No)

11. Yes. Since both parts of a double entry in the Journal is made at once for each transaction, the debits should equal the credits, and this can occasionally be checked by adding both columns. The column totals are shown in small numbers called "footings" below the last amount.

12. As you can see, all transactions are recorded in the journal chronologically. For certain purposes, a chronological record like this is quite useful. But for the analysis of operations and condition, transactions must be grouped or classified into accounts, like Cash, Accounts Payable and so on. The account sheets are bound in a "general ledger" or simply "the ledger". Sometimes smaller "subsidiary ledgers" for certain accounts are also kept.

13. When a purchase of equipment is made on credit, the invoice is received and the transaction is recorded in the journal, debiting equipment and crediting accounts payable. Then later, these entries are transferred, or recorded on to the account sheets.

14. This process is called "posting". After posting, you can look at each account and see, for example, how much equipment is owned, or how much money is owed as accounts payable. What is the name for the book of account sheets? (journal) (ledger) (general balance)

15. Yes. Remember, the transaction normally goes from business papers to the journal to the general ledger of accounts. What is the name of the process for this last step? (trotting) (posting) (cantering)

16. Yes. Posting provides the summaries of classes of transactions shown on the account sheets in the ledger. The date, amount, and journal page number are copied on the ledger sheet on either the debit or credit side of the account. A purchase of equipment on credit, for example, would be recorded in the ledger in the equipment asset account and on the accounts payable sheet.

17. It's important to remember that debit entries in the journal are posted to the debit side of the corresponding ledger account, and journal credit to ledger credit. At this time, the account number is noted in the journal's "reference" column. What three entries are made in each account when posting from the journal? (date of transaction, amount of money, journal page) (note the account number in the journal's reference column)

18. Yes. Normally the year and month are not repeated in the date. When posting, don't forget that in addition to the three entries in each account in the ledger for a transaction, there is one more, a fourth step. What is it? (always write the amount on a check stub) (note the account number in the Journal's reference column)

19. Some accounting steps are relatively routine, requiring care and attention, but not much judgement. But in making the original entry, judgement must be used in deciding whether the transaction was, for example, a debit or credit to cash, and what other account is also affected. In posting, less judgement is required, since the date, amount, account name and "effect", (debit or credit) is already in the journal.

20. When posting is up to date, every transaction in the journal appear in the ledger, and both journal and ledger are cross-referenced. The account number is in the journal's reference column and the journal's page number is in the account reference column.

21. At this time, a trial balance may be taken as a check to assure that the total debits and credits in the ledger are equal. Each total is written in small numbers at the bottom of the last entry in each column. What is this called? (noting) (footing) (netting)

22. In double-entry bookkeeping, the total debits of all accounts must always equal the total credits; otherwise there is some mistake. In some respects, making neat entries is an exacting, tedious process, and mistakes are inevitable. About one percent of the initial steps contain some kind of error, so the accounting procedure is organized to eliminate errors. The trial balance is a means of checking for errors by determining if total debits, after posting is complete, equal total credits.

23. In taking a trial balance, which can be done at any time, each account is totalled and "footed", the difference between debits and credits found, and the difference written in small numbers, on the side with the larger total. In a certain cash account, the total of debits was $10,600 and the total of credits was $3,200. What would you write? ($7400 in small numbers on debit side) ($6400 in the middle) ($7400 in big numbers on credit side)

24. The trial balance has a heading with the company name, "trial balance", and the date of the last entry, even though the balance was made up later. List the account titles and numbers in order, recording the net balances in the respective debit and credit columns. Add the columns. If the totals are not the same, there is an error somewhere. And even if they are equal, there may be an error, but that is much less likely. Follow the procedure described, and errors can usually be found.

25. You will recall that the two important major financial statements are the income statement and the balance sheet. These statements are important to a business, because when read carefully, they clearly reveal the operations and condition of the company. They are sometimes prepared monthly, are often prepared quarterly, and must always be prepared annually.

26. Besides the two important financial statements, an organization may frequently review total sales, certain accrued expenses, and the cash balance. But what are the two major financial statements? (revenue balance (taxes), expense sheet(taxes)) (income statement (operations), balance sheet (condition))

27. Right. At the top, the income statement has the company name, "income statement", and the period of time covered by the statement. The total revenue, (for a personal service firm, or sales, for other firms) is first listed, followed by the operating expenses, then ending with the difference, the profit. If the difference is negative, there's a loss.

28. The income statement uses some of the information which was on the trial balance, since the trial balance has the net balance of every account, including revenue and expenses. But the income statement doesn't present all of the accounts, since the income for a period is not directly related to assets or liabilities at a certain time. There is a report which is. What is it? (Balance Sheet) (work sheets)

29. Yes. At the top the balance sheet has the business name, the title "Balance Sheet", and the date of the statement. To be consistent with debit balances on the left and credits on the right, the assets are shown at the left and liabilities and equity on the right. You recall that debits equal credits and assets equal the total of liabilities and equity.

30. Cash, supplies, equipment, inventory and other assets are listed under the heading "Assets" at the left, and accounts salaries and notes payable and other liabilities are listed under the heading "Liabilities", at the right. Below "Total Liabilities" is the heading "Equity", with capital, net retained income, and other equity items under it. Finally there is the "Total of liabilities and owner's equity". This should equal what figure? (total assets) (total expenses) (total revenues)

31. Yes. On a balance sheet, assets are usually shown on the left side and liabilities and equity are shown on the right. Why do you think this is done this way? (assets increase by debiting (left column) while liabilities and equity increase by crediting) (assets are what is left after liabilities are rightly removed for equity)

32. Yes. Remember there are two principal kinds of books, the journal, a chronological record of original entry, and the ledger, which binds all the account sheets together. Both books may have subsidiaries, such as the Cash Journal, and the Accounts Receivable Ledger. In which book does the entry first indicate which accounts are involved in a given transaction? (journal) (ledger)

33. Yes. There is a kind of work sheet, not a formal report, which is used to check the accuracy and completeness of these books by checking if their total of debits and credits are equal. What is it? (balance sheet) (trial balance) (income statement)

34. Correct. The balance sheet and the income statement are formal reports. One states the financial condition of the organization at a given time, and the other shows the financial operations of the organization over a given period. Which is which? (balance sheet – given period, income statement - given time) (balance sheet - given time, income statement - given period)

35. When checks are written, carbon copies or check stubs provide an immediate record of cash payments. Later, returned cancelled checks confirm the creditor's receipt of this payment. Receipts, cash register tapes, sales tickets and invoices also provide records of transactions. What would an accountant call such documents? (Preliminary Reports) (Business Papers (immediate records)) (Final Documents)

36. A single written record of a single transaction is called an entry. Each Journal entry is based on a document such as a slip or stub, and contains several facts. What are they? (date, accounts affected, amounts, explanation) (location, section, persons involved, time)

37. Besides the General Journal, sometimes there are special journals such as the Cash Receipts Journals and the Cash Disbursements Journal. This may provide security, more accuracy, and specialized training. The various special records called accounts are collected in a ledger, and sometimes special ledgers are set up, such as Accounts Receivable and Accounts Payable Ledgers. How would you describe the ledger? (the ledge on which financial files are kept) (the collected account sheets, often in a single binder)

38. As you have learned, the debit column is always on the left and the credit column on the right. When assets are increased in value or amount, it is by an entry in the left, or debit side. From these two facts, we can always derive relationships like: credit entries decrease assets; credit entries increase debts or liabilities, and like liabilities, equity is increased by credit entries. Which of these is true? (debit entries decrease liabilities, debit entries decrease equity) (debit entries increase equity, credit entries decrease liabilities)

39. Four questions must be answered for each journal entry. The first three are the accounts involved, whether they are increased or decreased, whether they are assets, or are liabilities or equity. These three questions then decide the fourth, whether to debit or credit. How would you find out whether an account was, say, an asset or liability? (Look in the Chart (list) of Accounts) (ask someone) (flip a coin)

40. Accounting provide timely financial information about a business to owners, managers, creditors, government and others who need this information. Different accounting systems employ the same general bookkeeping process which is designed by accountants and is performed by bookkeepers. How could you describe this process? (indicate by stubs, specify by notes, mention in sheets, collect in files) (document by business papers, record in journals, classify in ledger accounts, summarize in reports)

Income Statement and Balance Sheet

1. An automobile driver must know how fast he is driving, in what direction, and at any given time he needs to know where he is. In the same way, the owners and managers of an organization must know their costs and income during a week, month, or a year, and their situation, or condition, say on December 31st or June 30th.

2. If every transaction has been properly entered into a firm's books of account, a list of these accounts and their net balances provides the first stage for reporting the operations in a period of time which has just ended, and the financial condition at that time. What is the name of this list of accounts and their balances? (account list) (balance list) (trial balance)

3. Right. This list of accounts and their balances is also useful in making the periodic adjustment in the accounts, such as in depreciation and prepaid expense, in closing temporary equity accounts of revenue and expense, and in preparing the periodic financial statements. When such a list is written with several sets of columns to do these things, what is it called? (End-of-period work sheet) (Balance sheet)

4. Yes. Work sheets aren't financial statements, of course. They are just aids to preparing them, and for proving the accounts. Usually no one but a bookkeeper or accountant ever sees a work sheet, or even a trial balance.

5. The first two columns of the work sheet are for the initial trial balance, the list of accounts and balances. Errors are checked and corrected at this point. Then the next pair of columns may be used for entering periodic adjustments such as depreciation, with the third pair used for the "adjusted" trial balance, combining the first two pairs of columns.

6. Adjustments include the replacement of beginning inventory with the final inventory, the recording of interest expense which has been accrued but not yet paid and interest income earned but not yet received, the recording of prepaid expenses like insurance and supplies which have been used up and expensed, recording depreciation, and entering a reserve for bad debt losses. Which sort of entries are the most likely? (debit: summary with beginning amount, credit: merchandise inventory) (debit: merchandise inventory with end amount, credit: summary)

7. Yes. To remove the beginning inventory from the Merchandise Inventory account, you credit that account, and to enter the ending inventory into the Merchandise Inventory asset account, you of course must debit it. In each case the offsetting debit and credit entries are made to the Expense and Revenue Summary which you are preparing.

8. Another end-of-period adjustment is made by debiting the asset account Accrued Interest Receivable and crediting the temporary revenue account Interest Earned by the amount of any interest which has been earned by the end of the period. The reverse is done for interest

expense. How would this be entered? (debit interest paid, credit accounts receivable) (debit interest expense, credit accrued interest payable)

9. Right. The Prepaid Insurance account is set up when the policy is paid, or set up as a Payable, but charged off as expense proportionally to the time expired of the insured period. If the insurance premium is $200 per year, and it was first purchased on September 1, how much insurance expense has been accrued by December 31st? ($66) ($133) ($200)

10. Another deferred expense may be supplies; since if $600 worth were bought at one time, enough to last a year, only $50 should be charged as an expense each month. What end of period adjusting entry should be made? (debit supplies, credit Accounts Payable) (debit Supplies Expense, credit Supplies (Inventory or deferred expense))

11. Right. Equipment which originally cost $5000 might be depreciated over 50 months, or at a rate of $100 per month. If it had been owned for, say, 20 months, it had a value, after depreciation, of $3000. In a year, Equipment Depreciation Expense would be debited a total of $1200, and accumulated Depreciation credited $1200. What does this do? (debit Depreciation Expense increases expense $1200; credit Accumulated Depreciation decreases Equipment value) (debit Expense saves losses credit depreciation causes cash flow)

12. Yes. At the end of an accounting period a new amount should be set up for bad debts on the sales which resulted in receivables during the period. If such sales were, say, $50,000, and a 1% reserve was thought reasonable, a debit entry of $500 in Bad Debts expense would be made, offset by a credit to the contra-asset account, Allowance for Bad Debts.

13. After these and other end-of-period adjustments, the third pair of columns on the work sheet is used for the Adjusted Trial Balance. The amounts for all of the Trial Balance accounts for which there is no entry in the Adjustments columns are repeated without change in the Adjusted Trial Balance. For these accounts which also have entries in the Adjustments column, the amount are added, or in event of entries in different columns, they are subtracted, to provide the entries for the Adjusted Trial Balance.

14. In the case of the generally offsetting Beginning and Ending Inventory figures, however, do not subtract, but carry both debit and credit amounts over to the adjusted trial balance columns, since they will be used later. What are the first three pairs of columns in the Work Sheet? (1. Trial Balance 2. Balance Sheet 3. Income Statement) (1. Trial Balance 2. Adjustments 3. Adjusted Trial Balance)

15. Right. The next pair of columns may be used for the income statement, and the last pair for the balance sheet. The income statement includes extensions of sales, sales returns, purchases, purchase allowances, discounts, and interest earned, as well as the various expense accounts.

16. The amounts from the Expense and Revenue Summary Account are also carried to the income statement columns, and totaled with the sales purchases and expense accounts mentioned. The difference between debits and credits, then, is the change in owner's equity during the period. What's another way of saying "change in equity due to operations"? (profit or loss) (decrease of the statutory indication of appreciation)

17. Yes. The asset and liability accounts are carried over on the Work Sheet to the last pair of columns for the Balance Sheet. These include accounts such as Bank checking accounts, (or cash), Petty Cash, Accounts Receivable, with contra-asset account Allowance for Bad Debts, Notes Receivable, Inventory, Prepaid Expenses, if any, such as Insurance and Supplies, Equipment assets such as furniture, fixtures, automobiles, machinery and so on, and their contra accounts for accumulate depreciation.

18. Liability accounts in the balance sheet column would include Accounts, Notes, and Accrued Interest Payable, and FICA, Unemployment, Sales Withholding and other taxes payable. Besides assets and liabilities, what else do you think should appear on the Balance Sheet? (Income and Expenses) (Revenues and Disbursements) (Equity (Capital, drawing accounts))

19. Right. The totals of the Assets, Liabilities and permanent Equity entries in the Work Sheet which have been carried to the Balance Sheet columns are now subtracted. If the debits are larger, there's a profit, if credits are larger, a loss. Notice which items are debits and which are entered as credits.

20. This difference, profit or loss, should of course be the same as the differences between the debit and credit totals of the Income Statement columns. This income figure should be recorded on the next line down on the Work Sheet. A profit will, as you can see, be a debit in the Income Statement and a credit in the Balance Sheet columns. Now you can write the equal balance totals on the bottom line.

21. It is relatively easy to understand why income must equal the difference between total revenues and the total of the cost of items sold and the expenses during the period. But it is not quite so easy to see why income (or profit) also equals the relative change of assets compared to change in liabilities during the period. Before entering a net profit in the Balance Sheet columns of the Work Sheet, how are their totals out of balance? (debits exceed credits) (debits equal credits) (credits exceed debits)

22. Yes. It would seem reasonable that if during a period the assets, which are debits, increased more than liabilities, which are credits, a profit was earned; (unless more capital was invested). Net Income would also be indicated if liabilities decreased more than assets, or also if the assets increased and liabilities decreased.

23. If in a period with no change in owner's investment, a firm's total cash, net receivables, inventory, equipment and other assets increased from $50,000 to $56,000, and its liabilities increased from $20,000 to $28,000, what happened? (profit) (breakeven) (loss)

24. Right. The income statement is the most useful report for providing information about profit and loss and why it occurred. It states the amount of revenue, the cost of the goods sold and the amount of each of the expenses as well as the net profit during the specified period.

25. The Balance Sheet, on the other hand, shows the amount of each kind of asset which is owned at a specified time, as well as the amounts of each kind of liability, and the amount of owner's equity. Which statement would you look at to find how much rent was paid? (Income Statement) (Balance Sheet)

26. Yes. In boom times especially, the income statement is considered the more important financial report, since even a small or weak company will become big and strong if it shows consistent and substantial income. The income statement is also sometimes called "statement of operations", "Profit and Loss Statement" (or "P. and L."), "Revenue (or income) and Expense Statement" or "Earning Report". Be sure to use such a title, as well as the period and the name of the firm, as a heading for the report.

27. Creditors, Income Tax agents, management and owners, all wish to see the income statement. They decide respectively whether to lend money, ship goods, audit tax returns, ask for a raise or promotion, or stay in or quit the business, after reviewing the report.

28. Since income or profit is what is left over, it is customary to put it at the so-called "bottom line", an important position. The top position, also important, is usually held by total revenue, or sales. Next, sales returns are subtracted to provide "net sales". The purchase cost, including freight and other direct costs of the goods sold, is then subtracted to provide Gross Margin. Which report would be most important to an IRS agent? (Income Statement) (Petty Cash Account) (Balance Sheet)

29. Yes. Notice the reducing order of differences: Net Sales after returns are subtracted, and Gross Margin after Cost of Goods Sold is subtracted. Then the total expenses, which are itemized and indented, are subtracted to obtain net pretax profit, or net operating income. This is the "bottom line".

30. Income statements are, and should be, rather clearly written and arranged, but an experienced person may be able to learn more than others by studying it. One way to find out more about what happened is to compare the statement with previous income statements; the second quarter-year income may be compared with the first quarter, or the second quarter of previous years.

31. To assist any reader of your income statement, you may add extra columns with this earlier information, so that each revenue and expense item can be compared with a comparable earlier period. Would it be helpful to learn that although sales were higher, profits were lower because interest expense had increased? (Yes, of course) (No help)

32. Yes. Sometimes it is helpful to simplify the numbers by reducing them to percentages. For example, if sales in the first quarter were $41,000 and gross margin was $12,300 while second quarter sales and gross margin were $59,000 and $13,000, what would you notice? (Sales and profits increased) (Sales increased but gross margin dropped from 30% to 22% of sales)

33. Right. Percentages might help you notice trends in cost or expenses. Obviously the actual dollar costs are important for relatively stable expenses such as rent, utilities, salaries and supplies, so changes in dollar amounts are also revealing.

34. When economic conditions are not booming, the Balance Sheet may become the most interesting financial statement about the firm, for even when there is little profit being earned, if assets exceed liabilities substantially, the company can continue in operation. What factor is made up of the differences between assets and liabilities? (expense) (owner's equity) (revenues)

35. Yes. The Balance Sheet is also called the "statement of assets and liabilities" although it also includes equity. Sometimes it is called Statement of Condition or Statement of Financial Position. Clearly, creditors and potential creditors such as suppliers and bankers, and government agencies of various kinds, as well as managers, owners and prospective owners wish to see the Balance Sheet.

36. The "report form" of the balance sheet or Statement of Condition merely lists assets, liabilities and equity in turn, on a single column or page. The "account form" of a balance sheet has the assets on the left and liabilities and equity on the right, often on a facing page. Such an arrangement is suggested by the left-and-right arrangement of an account sheet with the debits (assets) at the left and credits (liabilities) on the right.

37. At the top is the name of the organization, the term "Balance Sheet" or equivalent, and the date for which the report applies. Why doesn't it refer to an accounting period? (The statement does not show the periodic arrangement of the balance in the reports) (It refers to condition at a given date, rather than operations during a given period)

38. Right. Assets and liabilities are classified as short-term (or current) or long-term. Cash, accounts, short term Notes Receivable, temporary investments, and inventory are current assets, while accounts and short-term Notes Payable, taxes, salaries and the like are current liabilities.

39. Relatively long-lived equipment and facilities are "fixed" assets, and their purchase cost, less depreciation, is their remaining or "book" value, which approximates their market value as used assets. Land is not depreciated, since its value doesn't usually decline. Notes, including mortgages, which are payable in later years are classified as long-term liabilities. Which of these is a fixed asset? (cash) (Accounts Receivable) (buildings)

40. In analyzing Balance Sheets, comparative figures from earlier dates are useful, to note changes or trends. Fluctuations in cash are relatively less important, since receipts and disbursements fluctuate, but factors such as the "quick assets", including cash, receivables and the like are of interest, as is the ration of current assets to current liabilities, total liabilities to equity, and similar ratios. Current assets less current liabilities are called "net current assets" or "working capital" and have obvious importance. What reports would you prefer to see if you were a banker? (Income Statement, Balance Sheet) (Inventory breakdown, Petty Cash Report)

Simple Business Accounting

1. On January 1, Robert Johnson organized and invested $10,000 in the Bob Johnson TV Repair Co. On that day he bought a $5,000 van, paying $1,000 down and borrowing $4,000 to pay for the rest of it. He bought $2,000 worth of electronic parts for inventory, paying $1,000 in cash and charging $1,000 worth.

2. At the end of the day, Johnson made up a balance sheet which the bank and the credit bureau asked for. How much was his company's net worth; that is, how much equity did he have? ($5,000) ($10,000) ($15,000)

3. Yes, of course, but he didn't have that much cash left. He started with $10,000 cash, but paid $1,000 of it on the van, and $1,000 on parts for inventory. Thus, he had only $8,000 left in cash. The other $2,000 was invested in part of the van and part of the inventory, which, like cash, are assets. How much did the company have as total assets? ($5,000) ($10,000) ($15,000)

4. Right. Total assets were $15,000 and the equity, or "net worth" was still $10,000. How much in liabilities were there? ($5,000) ($10,000) ($15,000)

5. Yes. We might say that the Johnson company has assets of $15,000 for which it owes, or has liabilities, of $5,000; and thus there is an equity of $10,000. Now assume that a total of $500 is paid for utility deposit, advance rent and insurance premiums. We'll call this "Deposits and Prepaid Expenses", or just "Prepaid Expenses".

6. If the Bob Johnson TV Repair Co. operated on a cash basis, advance payment of rent, insurance and the like would merely be charged as an expense when paid, rather than recorded as an asset until the expenses are accrued, as is done in the other kind of accounting system. What kind of system is this? (cash basis) (accrual basis)

7. Right. In paying for these prepaid expenses, the company reduced one asset and increased another asset. What were they? (reduced (credited) cash, increased (debited) prepaid expenses) (reduced (credited) receivables, increased (debited) inventories)

8. Yes. At the end of January, Bob Johnson found that he had received revenues of $4,000, made purchases of $1,000 of parts for inventory, and accrued a total of $2,000 of salaries and other expenses. What other information is needed to find the profit? (cash and receivables) (notes and payables) (change in inventory, if any)

9. Right. In this case, we will say that the inventory of parts remained the same, at $2,000. What was the profit? (Revenues ($4,000), less expenses ($2,000), less purchases ($1,000), less inventory decrease (0), equals profit ($1,000)) (Expenses ($2,000), plus purchases ($1,000) less revenues ($2,000), less inventory ($2,000), equals profit ($2,000))

10. Yes. The January net revenues for Johnson's company would be easy to determine; just the total of sales slips, less total credit slips for returns. These transactions would be entered on a pair of columns in a combined journal, or in a special "sales journal". The expenses, however, were of several kinds, and required a numer of month-end adjustments to determine.

11. Rent, utilities and insurance expenses totalled $400 for January. But on January 1, there were deposits or advance payments of $500 for these expenses, so by January 31, we will say that no further cash payments for them had been made. In making month-end adjustments, what would be left in these accounts? (rent, utilities, insurance expense $400 (debit balance), prepaid expenses $100 (debit balance)) (prepaid expenses $500, rent, utilities, insurance expense $100)

12. Yes. Bob Johnson had two assistants in the store and shop, who were paid $1,000 total wages in January. How was this shown in the journal? (debit cash $1,000, credit salary expense $1,000) (debit salary expense $1,000, credit cash, employees, FICA, WH taxes, payable a total of $1,000)

13. Right. The automobile expenses were $200, the depreciation on the automobile $100, interest expense $100, and miscellaneous expenses, $200. Total expenses were then $2,000. Do you have enough information now to calculate how much cash was left? (Yes) (No, some of the assets may be Accounts Receivable)

14. Right. Here are the list of accounts and their balances before adjustments. What's missing at the top? (Bob Johnson TV Repair, Trial Balance, January 31, 19--) (Address and telephone number)

15. Yes. This trial balance already contains adjustments, since the month-end entries for rent, depreciation, utility expenses and the like are shown. And we will say that interest expenses and some others are included in "miscellaneous". If you were to make up an income statement, which accounts would you list? (sales revenue, returns, purchases, inventory reduction, salary, tax, rent, utilities, insurance, auto depreciation, other expenses) (cash, accounts receivable, van, accounts payable, drawing, notes payable)

16. Yes. Revenue, less the cost of the goods which were sold and the expenses, will give the profit on an income statement. In this example, there was no previous month to compare revenues and expenses, so Bob Johnson does not know if they are increasing or decreasing.

17. When all of the accounts are listed on an adjusted trial balance, there is enough information to write a Statement of Condition, or Balance Sheet. Which trial balance accounts would you carry over to the Balance Sheet? (revenue, expenses, returns, miscellaneous expenses) (cash, accounts receivable, auto, inventory, accumulated depreciation, accounts, notes, and taxes payable, capital, drawing)

18. Right, and like the Income Statement, it should have the company name and the title of the report. The Income Statement refers to the accounting period, while the Balance Sheet gives the effective date. Both reports must add the earnings, or losses, in order to make their respective accounts balance.

19. If Johnson required $1,000 for his personal needs, he withdrew this amount from the company in cash. Since he owned the company and supplied all the equity capital, he has this right. But if the company does not make a profit, what would happen if he continues to do this sort of thing? (nothing) (payables would change to receivables) (cash and capital would be depleted)

20. For nearly every expense, Johnson must pay, or set up an account payable and later pay, the amount in cash. In the case of expenses which are chargeable against prepaid expenses, like insurance, the payment is indirect, by the reduction of the Prepaid Expenses asset account. There is another "non-cash" expense, What is it? (FICA) (depreciation) (utilities)

21. Yes. On January 10, Johnson received an invoice from Electronic Supply Co. dated January 8, for $100 of capacitors, payment net 30 days. Electronic Supply's invoice had the number 264, 812 on it, but Johnson assigned it his Invoice Number 110. The package of capacitors came in that afternoon, so he wrote "Received Shipment in full 2/10/RJ" on the invoice and filed it in a pouch with a planned payment date. What was it? (January 20) (February 5) (February 9)

22. Right. February 9 is 30 days after January 8. At the end of the month, the unpaid invoices and bills were listed and totalled. What account should carry this total? (accounts receivable) (accounts payable) (notes payable)

23. Yes. You remember that on the first day of operation there was $1,000 payable for materials purchased for inventory. Johnson bought $1,000 of parts during the month. Let's assume he also paid $1,000 on accounts for purchases, for previous or new purchases. This still leaves $1,000 payable for the parts in inventory.

24. For our purpose we will also assume that on January 31 no salaries have been paid yet, but they have been accrued for payment on February 1, and that Bob Johnson has not drawn any money from capital. If Johnson works full-time in his company and is not paid a specific salary, his drawings are in lieu of salary.

25. If you were an accountant, and noticed that Bob Johnson withdrew $1,000 for personal use, what would you think? Accountants may be considered as experts who merely employ accepted accounting principles, but never apply personal value judgements to financial situations. This obviously cannot be entirely true, since nearly every entry has aspects which may be considered by the accountant. In general, it is best to withhold judgement, since it is often impossible to know the whole story at once.

26. In this example, Employees' withholding Taxes would be payable on February 1 and would be set up as a liability, in the Taxes Payable Account. As of January 31, where is this potential liability? (in Salaries Payable(since salaries are unpaid, taxes not yet withheld)) (In Accounts Payable)

27. Yes. Here we have simplified the chart of accounts by combining some accounts which would probably be set up separately, such as withholding tax payable, FICA, federal and state unemployment tax, and perhaps other taxes payable, such as sales taxes. Other accounts which may be shown separately relate to sales and purchases. What are they? (sales slips, purchase refunds) (sales returns and allowances, Purchase Returns and Allowances, Purchase Discounts)

28. Right. Another account, related to Accounts Receivable, is Allowance for Bad Debts to alllow for customers who do not pay their accounts. Why isn't there a similar account related to Accounts Payable? (It is included in Prepaid Expenses) (The company intends to pay all its bills)

29. We have also ignored a number of other accounts for assets or expenses, such as office or store equipment, or the cost of their rental. We will assume this is included in Miscellaneous Expenses. In addition to Interest Expense, there may be a revenue account called Interest Earned, but here both have been omitted for simplicity.

30. A typical sale may be to Ellen Green for the repair of her television set. Parts were sold for $20, and $24 was charged for repair service. Sales tax of 5% was charged on the parts only, and the bill was paid in cash. Sales slip No. 127 was made out. What did it show? (Parts $20, Labor $24, Total $44) (Ellen Green, May 5, Parts $20, Labor $24, Tax $1, Total $45, Cash received $45)

31. Right. A copy of the sales slip was placed in a drawer along with some others, and on the next day an entry was made in the General Journal which noted the date of the transaction, the cash received, and the parts, labor and tax accounts which were charged. What entry amounts were made? (debit Cash $45, credit Parts Revenue $20, credit Service Revenue $24, credit Sales Tax Pay $1) (debit Revenue $45, credit Expense $45)

32. Yes. Such an entry, in all four parts, would be made in the Cash Receipts Journal or book, if such a subsidiary journal were maintained. In a few days, the journal entry was posted to the four accounts. If the transaction was in a general journal it would be posted separately to the cash account, but if a special subsidiary Cash Recepts Book is kept, it would be included in the single total cash amount posted.

33. The parts of the entry for Parts and Service sales may be individually posted, as credit, to the respective accounts, or they may be included in a single total posting of cash sales from the cash receipts book. This would be done for sales tax, too. How would you describe a Cash Receipts Book? (A General Ledger) (Subsidiary Journal) (Subsidiary Ledger)

34. Yes. An account, such as Cash, or Notes Payable, usually has a net balance; that is, the total of debits and credits are unequal. The entire General Ledger of Accounts, of course, due to the double entry system should balance out. How can Bob Johnson be sure of this? (By adding all receipts and subtracting disbursements) (By taking a Trial Balance (List and Total of Account Balances))

35. Right. In the same way that the total of ledger accounts must balance, the total of debits and credits of journal entries must balance. Johnson TV Repair keeps a General Journal, and special Cash (for credit sales) and Purchases journals. What would you call the process of checking them for proper balance? (proving the Journals) (checking the entries) (balancing the trial)

36. If Robert Johnson's business grows, he will probably be unable to finance its growth from earnings, and will want to borrow some money from his bank. The banker will need to know as much as possible about Johnson's sales, earnings and present condition. What reports provide this information? (sales -- Trial Balance, earnings -- Balance Sheet, condition -- Report of Accounts) (sales -- Income Statement, earning -- Income Statement, condition -- Balance Sheet (or Statement of Position))

37. Right. To produce these reports each month, quarter, or year, Bob Johnson's wife, Betty, helps out by taking the column totals in the journal, (if it is a general journal or combined cash journal), or the special subsidiary journals, and proves the footings. At this time errors are found and corrected. Any posting to accounts which has not been done is completed.

38. The bank balance is then proved and reconciled with the bank account statement for the month just completed. The other ledger accounts are then footed, showing the net debit or credit balance. At this time a work sheet with a list of the accounts and their net balances is made up and the overall debit and credit totals are shown. What would Betty call this work sheet? (trial balance) (tribulation sheet) (work book)

39. Yes. And if the trial balance, or list of accounts with their balances, is incorporated into a multicolumn period work sheet, the adjustments for depreciation, the use of prepaid expenses such as insurance, and the revenue and expense accounts can be conveniently made, and the income statement and balance sheet figures can be generated.

40. There are millions of organizations whose operations must be recorded and reported to their owners, or members, and others. Most of them, of course. are small, simple firms which do not require elaborate books of accounts. But in most of them, the procedures used require one or more journals, books of original entry, and one or more ledgers of accounts in which transactions are classified so they can be controlled, and from which data is taken to prepare periodic reports.

Service Business Accounting

1. When we think of business and business organizations, we often think first of large companies, especially manufacturing companies. While most firms are small, most business is indeed done by big firms, but not always in manufacturing. In fact, today many more persons are employed in service jobs for the government and in private companies.

2. Service may include transportation, as by airlines or railroads, banking, insurance, real estate and securities brokerage, entertainment, advertising and so on. These personal services are usually supplied through business enterprises. Professional services are usually supplied through professional enterprises, with one or more doctors, lawyers, dentists, accountants, engineers, or architects supplying personal services.

3. Two ways of accounting for revenue are on a "cash basis" and on an "accrual basis". A manufacturer, for example, uses the accrual basis because nearly all sales are made on credit, and the expenses and revenue are gradually accrued. But what kind of organization would more often perform accounts on a cash basis? (personal services firm) (merchandising firm) (manufacturing firm)

4. Yes. A doctor or lawyer, or perhaps even an advertising agency, would, more likely than a manufacturer, consider for accounting and income tax purposes that income has not actually been received until it has been paid in cash or equivalent.

5. In a similar way, one might keep accounts which enter expenses only when they are paid in cash, even though the liability for them might be accruing earlier. You can see that if the only revenue considered is the cash received, and the expenses accounted for were mostly shown as cash paid out, fewer entries might be made in the books. Which method seems to be the simplest? (cash basis) (accrued basis)

6. Yes. For this reason, personal service enterprises which use a cash basis for accounting are usually explained first, before considering the more complex details of accrual systems. But you should realize that such a simplified system may leave many questions unanswered, and ignore many factors.

7. One accrual expense which must usually be included is the depreciation cost of relatively permanent assets, such as equipment. Another may be supplies, bought in quantity, but used up slowly, although if there are several kinds of supplies which are purchased at different times and which are not too expensive, it may be better to charge them as expenses when they are purchased. Why is this? (permits cheating the tax collector) (avoids accounting for trivial inventory and use)

8. Right. The cash basis of accounting for the revenue and many expenses of a small personal service business is commonly used, and accepted by the Internal Revenue Service. There is one factor, of course, which must be remembered about cash basis accounting. What is it? (All cash revenue is for service which may be performed next month) (Some cash revenue and expenses are really for an earlier period)

9. Right. Let's say that Mr. Paul Jones is a professional product designer who works for various customers for fees. He would have asset accounts for cash and equipment, liabilities of salaries and of taxes payable, and equity accounts for originally paid in capital and monthly revenues and expenses, separated into fees received, salary, tax, rent, utilities, depreciation, supplies, automobile, and perhaps several other kinds of expenses.

10. Notice that on each payday if Mr. Jones were to send a check to the Internal Revenue Service for FICA and withholding, and to the state for tax withholding, (if required) there would be no liability accounts at all, since his secretary, bookkeeper or office manager would not record any bills until they are paid, and then only in the expense account.

11. Jones leases his car, so it's not an asset, and when the lease payment is due it is paid as an expense, rather than held for a while as a liability. But Paul Jones, Designer, purchased some office equipment. If it had been leased, instead, and taxes paid as incurred, how many asset and liability accounts would there have been? (Asset Account: cash, Liability Accounts: none) (Asset Accounts: cash, Accounts Receivable, inventory, supplies, automobiles, intangibles, Liabilities: notes, bonds, stock)

12. Yes. And this is a common and legitimate accounting system. But Jones may have several asset accounts, such as cash in the First National Bank, a petty cash account, equipment, and equipment depreciation. Depreciation, you remember, is the cost related to the continually reduced value of an asset as it gets older or worn out. And there are usually the withholding tax liability accounts, since taxes are not remitted on each payday.

13. Jones keeps a combined cash journal and a general ledger with about a dozen accounts bound in it. In addition, he has a small book for petty cash disbursements, some envelope files for employees' earning records, a file of unpaid invoices he has sent his customers, and a folder in which bills are held for periodic payment. No receivebles or payables are set up as assets or liabilities. What kind of accounting system is this? (accrual basis) (cash basis)

14. Right. A specially-designed combined cash journal allows this book of original entry to display all and organize most of the transactions of a simple personal-service enterprise. Nearly every entry involves the cash account in some way; either a deposit for a payment from a client for services, or a payment to an employee or supplier. For this reason, the debit and credit columns of the company's main checking account are isolated, here at the left of the transaction description column.

15. A typical entry in the journal would be a payment for gasoline and other auto supplies to the Martin Service Station. Their bill for July was $85, paid on August 10th. What entries would be made first? (debit cash, credit payables, debit receivables, credit expenses) (write check; credit cash, debit auto expense(enter in "General" column of journal))

16. Right. When Mary Smith, an employee, was paid for her work, $100 was debited to salary

expense, $90 was credited to Cash for her pay check, $6 was credited to FICA taxes payable, and $4 was credited to employees' withheld income tax payable. In this transaction, did the debits equal credits? (Yes) (No)

17. Each week, or probably at least twice a month, each column in the combined cash journal is totalled, footed and proved. How is this done? (the sum of the totals of the credit extended is footless) (sum of footed totals of debit columns equal those of credit columns, (or error is found))

18. Right. Remember, the journal is simply the chronological record of transactions. A combined cash journal, often used in personal service organizations, (particularly proprietorships owned by one person) is especially suited for accounts kept on a cash basis.

19. Deposits in the bank accounts of a professional service proprietorship are usually made less often than withdrawals by check, since there are often fewer clients than employees and suppliers. When payments received from clients are deposited, a credit entry is made in the combined cash journal "professional fees" column. Where is the debit entry made? (debit cash(deposits)) (debit salary expenses) (debit checks written)

20. A person who owns and operates a service enterprise is usually paid by periodic withdrawals which are recorded in a "drawing account", and in the journal. The owner must then separately file FICA and income tax payments and returns.

21. At the end of the month, or other accounting period, in addition to proving the journal, all of the entries in the General debits column should be posted to the individual accounts. Then the sums of each of the other columns should be posted to their respective accounts. This is called "summary posting", and it saves making entries for all of the individual transactions in the ledger accounts.

22. Remember, the checks and account numbers are entered into the posting reference columns of the journal as the posting is done. As the column totals are proved, they are entered at the bottom of each column, with a ruling above and a double ruling below the totals. Below these totals, for all but the General Debits and Credits, are numbers in parentheses. What do you think they are? (numbers of accounts which are summary-posted) (numbers used to remind the bookkeeper of the date)

23. Yes. Just check-marks are used below the General Debits and Credits columns to indicate completed posting. After posting is complete, a trial balance of the ledger accounts is prepared. For a trial balance each account is totalled, footed, and then what? (total account debits and total credits are summed; debits must equal credits) (the debits are transferred to the left column of the journal from ledger)

24. Yes. At the end of each accounting period the owner should have reports of income during the period and the financial condition at the end of the period. These are the income statement, and what? (accounts sheet) (balance sheet) (swindle sheet)

25. To prepare these reports, some special entries should be made, such as the accrual of depreciation expenses. In addition, the temporary equity accounts of revenue, expense and owner's withdrawals should be closed out and set up for the new period.

26. A "work sheet" is used to close out these accounts and prepare the periodic reports. A wide column is provided for the account names, a narrow one for their numbers, and several ruled columns are available for the trial balance, and adjustments, the income statements and the balance sheet. Which of these are temporary equity accounts? (cash, equipment) (salaries and Notes Payable) (revenue, expenses)

27. The trial balance is of course merely a listing of the accounts and their balances. The debits totals should equal the credit totals. The "adjustments" usually include periodic charges for depreciation, which is the cost associated with the declining value of equipment which is owned and used. For example, if the organization owned $12,000 worth of equipment which has a ten-year life, with its value determined to be uniformly decreasing, a charge of $1,200 per year would be made for depreciation. This could also be shown as $100 per month.

28. The adjustments would then consist of the amount of the depreciation, (say $1200 for a year) entered into both the "accumulated depreciation" line, adjustments-credit column, and "depreciation expense" adjustments-debits column. How could you describe depreciation? (charge for use and value decline of equipment owned) (income for depressed assets offsetting charges)

29. Yes. Depreciation is thus considered a periodic expense, as well as a periodic reduction in the value of an asset. It's a non-cash expense, which means that an actual payment for this expense is not made each month of the year, as are most other expenses, but it is a real expense which must always be accounted for.

30. On a work sheet for a periodic report of a simple service proprietorship, the first two columns may be for the trial balance, the next pair for adjustments such as depreciation, and the third and fourth pairs for the statements about operations during the period and the financial condition at the end of it. What are these two statements? (operant sheets, statement of imbalance) (Income statement, Balance sheet)

31. Right. In using a work sheet with four pairs of columns for Trial Balance, Adjustments, Income Statement and Balance Sheet, the figures from the Trial Balance are combined with the Adjustments and carried over to the last two statements. The revenues and expenses are shown in the income statement columns, while the assets and liabilities are carried to the balance sheet columns.

32. But now the debits and credits don't balance, since, for instance, the total revenues probably don't equal the total of expenses. Why not? (there may have been some profit or loss(net income)) (there is always some kind of error)

33. Yes. The net income, in fact, is just the total revenues less the total expenses, and if the total income for 1976 were, for example, $50,000 and expenses were $25,000, the income was $25,000. This is shown in this way in the income statement.

34. The net income during the period affects the condition at the end of the period as shown by the Balance Sheet, too. Where will its effect be primarily shown? (assets) (liabilities) (equity)

35. Right. Equity is affected by profits and losses, and by investments in the firm, and by withdrawals from it. Profits, positive or net income, and investments made in the firm increase its equity, while losses and withdrawals decrease equity.

36. This balance sheet is in "Report Form", with Assets at the top, and Liabilities and Equity shown below the assets. "Account Form" balance sheets always haveassets at the left, and liabilities and equity at the right. "Current" assets are expected to be converted to cash, "Fixed", "long-lived" or "long-term" assets are expected to be used for several years. What are some examples of current and long-lived(fixed)assets? (current - cash, receivables, long - equipment) (current - building, long - checks)

37. Yes. Current liabilities must be paid within 12 months; long-term liabilities, after at least one years. What are some examples of such liabilities? (current - inheritance in 1995, long-term - last month's rent) (current - telephone bill, long-term - loan due in 5 years)

38. Right. At the end of the accounting period, when the temporary equity accounts of revenue and expenses are to be closed out, and after adjusting entries like depreciation are made, "adjusting and closing" entries are made in the journal, then posted into the appropriate accounts to adjust and close them.

39. For example, Depreciation Expense is debited and accumulated depreciation is credited as an adjusting entry. Typical closing entries are debiting the total of revenues and crediting the expense and revenue, (or income) summary with the same amount; then debiting this summary with the total expenses, and crediting each expense account which makes up the total.

40. Finally, the summary is debited with the total net income for the period, with the Capital Account credited with the same amount. And the Capital Account is debited with the total withdrawals from it by the owner, this amount being credited to the owner's drawing account. What balances are then left at the beginning of a new period in each of these temporary equity accounts in this simple accounting systems? (zero) ($1.00) (100%)

Accrual Accounting in Retail Firms

1. In a previous program you learned about keeping accounts on a simple cash basis. Revenue and expenses were recognized and entered as received or paid, whether they were earned or incurred in the reporting period or not. For a larger firm with a complex business; for example, a retail firm, the accrued accounting procedure is more useful.

2. Goods are usually purchased on credit and often sold on credit too. Nearly all obligations are eventually paid, so for practical accounting purposes we can begin by assuming that all bills will be paid to suppliers, and charge accounts payments will be made to the firm by its customers. Cash basis accounting would not be fully useful to such an organization. Why? (most transactions involve credit) (cash is never received or paid)

3. Yes. In accrual accounting, revenue is considered earned when goods and services are sold and delivered, even though cash is not received, because at that time an account receivable from the customer is created. In the same way, an expense, such as Salaries Payable, is "accrued." Accrual means a gradual or natural increase.

4. Of course, some things accrue continuously, like salaries, rent or depreciation, while others, like retail sales, occur as discrete events. For practical purposes we don't accrue rent or depreciation by the minute or hour, but by a convenient period such as a month. This is usually an accounting period.

5. Salaries are often paid by the end of an accounting period, but if not, the amount of salaries still payable is a liability, and the total salaries accrued during the period, whether paid during the period or not, is accrued as an expense. How could you define "accrued"? (sudden, ruthless, disbursal; loss) (gradual, natural increase; accumulation)

6. Right. At the end of the accounting period, "end-of-period adjustments" are made to establish proper accruals. It might seem hardly worth quibbling about the precise allotment of certain income and expense items to one period or the next, but many wholesale and retail firms operate with narrow profit margins, and it may be essential to determine small or gradual changes in expenses or income so that appropriate management action may be taken promptly.

7. A larger firm usually has more accounts. Its "chart" (or list) of accounts may include those for petty cash, one or more bank accounts, accounts, notes and interest receivable plus allowance for bad accounts; inventory, prepaid expenses such as insurance and supplies, equipment and other fixed assets and possibly some investments. How are most accruals established? (by end-of-period adjustments) (by daily calculations)

8. Yes. Typical liability accounts for a merchandising firm are accounts, notes, interest and taxes payable. Equity accounts are capital and drawing accounts, plus a summary account of revenue, cost and expenses. These latter temporary equity accounts include sales, sales returns, purchases, returns and discounts, rent, utilities, insurance, salaries, commissions, taxes, advertising, delivery, supplies, and depreciation expense.

9. Merchants must operate in the real world in which some persons will fail for some reason to pay their accounts. When such accounts are finally considered uncollectable, they may be written off into an expense account such as "bad debt expense" or "uncollectable receivables expense". What are some other common merchandising expenses? (travel, entertainment, bribes, kickbacks, interior revenue) (rent, utilities, taxes, insurance, salaries, advertising, delivery, supplies, depreciation)

10. A common method for accruing bad debt expenses to the period during which the related sales are made is by setting up an amount in the "contra asset" account, "allowance for bad debts", equal to expected losses. If losses are usually 1% of sales, and sales were $100,000 in December but only $10,000 in February, the $1,000 reserve for losses should probably be set up in December to affect that month's profit or loss rather than later.

11. When an estimated allowance for bad debts is set up, the Bad Debts Expense account is debited, and Allowances for Bad Debts credited. Later, when individual accounts are considered uncollectable, what is done? (debit: Allowance for Bad Debts, credit: Accounts Receivable) (debit: Credits Collectable, credit: Debits Receivable)

12. Another rather special account is "Prepaid Expenses", which would include advance insurance payments or operating supplies purchased in advance. Such things are assets until they are used and charged off in each accounting period as actual expenses, so the debit balance in the Prepaid Expenses account is shown with the assets, even though it is not likely that they will be cancelled or returned for refund or credit.

13. In a Prepaid Expenses account there might be a balance of $1,000 of prepaid insurance and $500 of supplies. In August, the insurance expense was $100 and supplies expense was $50. What end-of-period entry was made? (debit: Insurance Expense $100, debit: Supplies Expense $50, credit: Prepaid Expense $150) (debit: Prepaid Supplies $150, credit: Prepaid Insurance $150)

14. Another asset account, that for equipment and other facilities, must be periodically reduced by an expense adjustment reflecting the use and reduced value of these assets. This is depreciation. The actual exact value of the facilities is not as important as the regular allowance for its reduction and its effect on earnings, for the used or eventual scrap value of the equipment may be different from the depreciated balance shown in the account.

15. Fixed (long-lived) assets can be written off, or depreciated, by constant or variable amounts each period. A computer or an automobile may be depreciated more the first few months or years than later, but a milling machine may be considered to be constantly reduced in value, which in a sense means a greater percent of its remaining value, as this value becomes smaller.

16. The constant-amount, (or straight-line) method of depreciation is the simplest, and is widely used. If the useful life of something is said to be 5 years, then one-fifth of its cost per year, or one-

sixtieth each month, may be debited to depreciation expense and credited to accumulated depreciation accounts. How much each month would you depreciate a $12,000 molding machine which has a ten-year life? ($100) ($1,200) ($12,000)

17. An accumulated depreciation account, like a reserve for bad debts accounts, is a "contra" account; it might be considered a liability, and its balance is usually "credit", but since it is so closely-related to a given kind of asset, it is carried next to the assets, rather than as a liability or merely as an entry in the fixed asset account, which would make it less apparent in a review. You will learn more about fixed assets in a later program.

18. When the accumulated depreciation of a particular asset equals its original value, depreciation charges for it are stopped; and even though the asset may still exist and be used, it is not shown to be of any value or further expense. When the asset is scrapped or sold, its asset value and accumulated depreciation amount are removed by an adjustment. What kind of accounts are Reserve for Bad Debts and Accumulated Depreciation? (counting accounts) (contra asset accounts) (contradictory accounts)

19. When merchants purchase goods from suppliers, they pay the wholesale price, not any established list price for retail customers. The difference is called a "trade discount" and may not be shown in invoices, but if it is, it is only in passing, for the net amount is shown at the bottom. There is, however, often a "cash discount", usually not specifically shown, for perhaps 2% of the net amount, which may be taken if the invoice is paid, within, say, 10 days.

20. The net amount of a purchase must usually be paid within 30 days. If you made a $1,000 purchase on April 1, and the invoice was marked "2%/10 days, net/30 days" or "2/10, net/30". What would you do? (probably pay $980 for it on April 10) (ignore it) (certainly pay $1,000 on April 2)

21. Yes. Management may wish to know how much has been saved by taking prompt payment discounts, so a separate "Purchases Discounts" account is often used. When the $1,000 is paid for the purchase, Accounts Payable is debited $1,000, Cash credited $980, and Purchases Discounts credited $20.

22. When a firm has a number of important customers and suppliers it may wish to maintain special receivable and payable accounts for them. These are called "subsidiary ledger" accounts. In the general ledger, "control accounts" are used to summarize the effect of the individual subsidiary accounts for each customer and supplier. Why do you think such subsidiary ledgers are used? (The account books are thicker, more impressive) (It is easier to review the condition of each account)

23. Right. A small company might be willing to keep a loose file of unpaid suppliers invoices, and a file of unpaid customers sales slips, but others would set up an account page for each customer and supplier, perhaps like this with three columns; for debits, credits, and for the resulting balance after each transaction.

24. Periodically the balance of the various subsidiary payable and receivable accounts are summarized in two accounts. What are they? (Accts. Pay. Control Acct., Accts. Rec. Control Acct.) (Accumulated Depreciation, Accumulated Bad Debts)

25. Yes. The various accounts with creditors, mostly suppliers, and the Payables Control Account will usually have credit balances, and are considered liability accounts. But it is possible that a supplier has been overpaid, or credit was given for returns after payment, so a debit balance exists. This rare event should be pointed out by red ink or a circle around the balance. Similarly, if a customer, who usually will have a debit balance in your receivable accounts had a credit balance, this should be indicated clearly by red ink or otherwise.

26. An accounting system may permit the direct posting of customers' or suppliers' accounts directly from invoices or sales slips, rather than from the Journal, the chronological book of original entry. What does a red ink or circled entry signify? (An unusual kind of balance) (a circular entry) (a colorful way of writing)

27. A supplier's or other creditor's credit account balance is increased when material from a purchase order is received, the invoice is received and checked and the entries are made. This credit balance may be decreased when there is an invoice sent for a charge-back for return, or discount allowance, or payment made, usually by check, or a note issued for temporary settlement of the account.

28. A customer's or other debtor's account with the firm is increased when goods from a sale are delivered, the sales slip is made out, filed, and appropriate entries are made. This debit balance may be decreased when there is a credit memorandum made for returned goods, or payment on the account is received, or a note from the customer is accepted for temporary settlement of the account.

29. Accounts Payable, then, are inceased by purchases, and decreased by allowances, discounts, notes issued and payments. Accounts Receivable are increased by sales, and decreased by returns, payments received or notes accepted. When payments are received by check, no special slip is made out, since the cancelled check is evidence, but when a cash payment is received for a customer, what document is issued? (A note for the amount) (a recipe for take) (a receipt for cash payment)

30. Right. In a small organization, credits for payment to a customer's account may be made directly from the check, but to separate bookkeeping from money and check handling, posting is often done from a list of daily remittances instead. (A remittance is money sent in.) Posting reference marks or numbers should always be entered as posting is completed. While restricting check handling may provide security, it tends to permit undetected errors, since two persons using a check to enter a journal and later to post accounts would seldom make the same error.

31. While firms purchasing from suppliers usually pay promptly for each separate purchase order and invoice, retail customers often pay periodically, usually monthly, as called for by a statement

of account. This statement contains a summary of the charges made, the payment received during the month, and the balance which is due to be paid by the customer.

32. It is common to send bills to customers on or about the first of the month, with the charges and balances shown as of, say, the 25th of the preceding month. What are these documents called? ([monthly] Statements [statements of account]) (Inventory invoices [account resumes])

33. Yes. Retail firms which use accrual accounting typically employ a Combined Cash Journal as a book of original entry, as well as special sales and purchase journals. Books of final entry usually include the General Ledger with 20 or 30 accounts, and the accounts payable and receivable subsidiary ledgers.

34. Auxiliary records usually include a petty cash disbursements file or book, one or more checkbooks, employees' earning records, and files for copies of various kinds of slips and tickets. What are typical books of original and final entry? (original: sales slips, purchase orders, final: cancelled checks) (original: Combined Cash, Sales, Purchasing Journal, final: General, Payable, Receivable, Ledgers)

35. A retail firm will probably wish to prove the footing of the combined cash journal each week, as well as the bank balance. Posting to the general ledger will be kept fairly current, with weekly proof. At this time the petty cash and sales journals will also be proved.

36. At the end of the month or other accounting period a trial balance is taken. Errors in entries and posting are corrected. Then adjustments such as depreciation expense and use of supplies are made. What would you call this set of columns? (columnar corrections) (adjusted trial balance)

37. A report of operations during an accounting period must include the charges for rent, utilities, insurance, salaries, taxes, advertising, delivery, supplies, depreciation and the like. What are these charges called? (Liabilities [must be paid]) (Expenses [temporary equity accounts])

38. A retail firm, like any company, must make profit in the long run to survive. Losses may occur over short periods, but they must be known quickly, and the reasons for them identified. What is one way to do this? (Prepare timely, accurately detailed reports of revenue, expenses and income) (Count the cash on hand at frequent intervals)

39. Yes. And in addition to finding the amount of revenue, expense, and profit during a period, managers must know the condition of the company at a given date, for even a profitable company must have a balanced inventory, sufficient cash and other current assets, and avoid excessive current liabilities. What kind of report tells about this? (Operating statement) (Balance sheet [statement of condition])

40. Right. In another program you will review the steps in the preparation of these periodic summaries which provide the basic information for owners and managers.

The Cash Accounts

1. While you may usually think of "cash" as the paper currency and coins you have, you know that for business much of the money which is transferred is in the form of checks, money orders or other kinds of drafts. All these things are called "cash items" and generally treated as cash by business.

2. Thus, the amount shown as "cash" on the balance sheet, as well as the positive balance shown by the cash account, are really the net totals of all these cash items. This usually includes the net balance in one or more checking accounts in one or more banks.

3. You remember that since cash is an asset account, it is debited when it is increased and credited when cash is decreased. The debit total is always greater than the credit total, unless there is no money in the bank account. Which are considered cash items? (checks, money orders, drafts) (receipts, notes, invoices)

4. Yes. If your company had information about its other assets and its liabilities which was delayed, or temporarily erroneous, it might be awkward, inefficient and embarrassing, but if information about cash were wrong or delayed, the result might be critical or illegal. Obviously timely and accurate records of cash are vital.

5. The common and effective ways of reducing error and embezzlement involve some duplication and separation of the functions of handling cash and keeping records. One usual way is by a receipt or cash ticket, one copy of which is attached to the cash item until a bank account deposit slip like this one is prepared and checked, and another copy of which goes to the bookkeeper. How should cash items be handled? (in casual, delayed, careless manner) (in careful, timely, accurate manner)

6. Right. An electronic or electromechanical cash register is used for large numbers of sales of relatively smaller sums. The tape provides a list of the receipts and often a code for the items sold. A copy is given to the customer and one is retained for accounting.

7. Cash payments, or "disbursements", by a firm are usually made by issuing a check on a bank account, but sometimes smaller or unusual disbursements are made in cash. Payments made by check are confirmed by the return of the cancelled check, but cash payments should be confirmed and recorded by obtaining a receipt. There are two meanings for "receipt". What are they? (any payment received; slip showing payment made) (repeated instructions; instructions for cooking)

8. Yes. You would expect that a large part of the total number of business transactions involve cash items, so it would be quite helpful in reducing the number of posting entries to arrange a special procedure for accounting for cash. One way to do this is by using a special journal form which has a separate set of debit and credit amount columns from those used for the other

accounts. This is called the "four column journal".

9. In this type of journal, as you can see, it is often possible to make the complete entry on only one line, which results in a more compact and convenient set of records. Entries which don't involve cash usually take two lines. What is the name of this accounting record which has separate places for the amount of cash and the other accounts? (Double-Debit Disbursal) (Four-Day Record) (Four-Column Journal)

10. Right. Like other journals, the four-column journal must be frequently proved; that is, the sums of debits and credits must be checked as being equal. Small pencilled footings are entered after the last entry, then the debit columns are added together, and the credit columns, as shown. After proving, the totals are entered in full-size ink numbers, with single lines above and double lines below them.

11. Journals are also proved at the end of the month, and the cash balance carried forward to the new month, sometimes on a new page. When a new page is needed for the same month, the full journal page is proved and totals are entered on its bottom line, and on the top line of the next page, marked "carried forward".

12. Posting from the four-column journal to the cash account is usually done only once each month, but posting from the "General" columns to the other accounts may be done at any time. When posted, the account number is noted in the posting reference column of the journal. Besides the entry itself, what posting note is made on the other account sheet in the ledgers? (the journal page number in the Posting Reference Column) (the date of the last footing)

13. Yes. You can imagine that, besides cash, there might be an account which in any given organization has so many entries that special debit and credit columns in the journal might be worthwhile. It might, in fact, be useful to have several special pairs of columns to save on entries into the ledger by periodically posting the balances instead of individual transactions. This sort of journal is often called a "combined cash journal".

14. On the other hand, it may be desirable to keep the cash receipts in an entirely separate journal, called the cash receipts journal. There may be a separate cash payments (or disbursements) journal, too. Since most companies pay by check, such a cash disbursements journal is just a check register. What's the name of a cash journal combined with a general set and several special sets of columns? (combination general register) (combined cash journal) (mixed general recorder)

15. Yes. Don't forget such journals are "original entry" books, with assets increased by debits, and liabilities and equity increased by credits. The journal entries in the "General" columns are each posted to the respective accounts, while the net totals of the cash and special columns are posted monthly. In each case the date, the description, the amount, as well as the name and number of the account is shown, either by the special heading or individual notation.

16. While nearly all of the transactions may be posted to accounts which are provided with special columns in the journal, there will always be a need for a General Journal, either as a separate book, or a separate pair of columns in a combined journal. How would you describe a journal? (book of original entry) (binder of final disposition)

17. Yes. Cash should be proved frequently. Subtract the total of cash payments during a period from the total of cash receipts and the balance at the beginning of the period. This should be the total of cash on hand and on deposit. The deposit balance is usually available from check stubs or their equivalent, on which the amount of each check written is subtracted from, and each deposit added to the previous bank balance to show a new balance.

18. The amount of cash and cash items on hand will, of course, be determined by a physical count and addition. What do you suppose you should do if there is an error in the cash account? (if short, resign) (if over, head for Mexico) (keep cool, recheck figures)

19. Right. Like any account, the cash account may not prove on the first trial, and if there are a large number of cash transactions, this is not rare. But even if the amount is small, be quite careful in rechecking entries, for the error may be due to two or more much larger but nearly offsetting errors.

20. If after a lengthy review the cause of the cash shortage or overage cannot be found, the books, in some organizations, may be balanced, if approved, by an entry to an account named "Cash Short and Over". At the end of a selected accounting period any balance in this account will then be treated as expense or revenue.

21. It is a good idea to deposit all cash and cash item receipts and to write checks for all disbursements, even for small amounts of cash needed to be kept on hand. A special account called "petty" (for trivial) cash is often used for special small expenses where cash payments are simpler or necessary. Besides the petty cash account, what is another common special cash account? (slush fund) (Cash Short and Over) (questionable cash)

22. Yes. A petty cash fund is set up by cashing a check payable to "cash" for an established amount; $10 or $100 or whatever is the most needed. The money is placed in a cash drawer under the control of a designated person. Money is paid from petty cash only when authorized, and when a slip or voucher is drawn with the date, amount, employee involved, payee and purpose are all noted, even if only by initials. These slips or vouchers are retained, and listed in a petty cash record sheet or book.

23. Such a petty cash disbursements book may, like a combination journal, be provided with several special and general or miscellaneous columns. Since few deposits are made, there may be no special debit column, but there is usually a single column for the amount of the cash disbursement, plus the other charge distribution columns.

24. When the money is nearly all disbursed, or at the end of the month, the petty cash account should be proved, and a check for the exact total of disbursements during the period written to bring the cash total on hand back up to, say, the established $100 miximum.

25. If the petty cash disbursements record has columns for distribution of charges, or if it is to be otherwise distributed to several accounts instead of just one expense account, the total petty cash charges to each of the accounts is transferred to the regular journal at the end of the month, along with the total of the cash disbursements, chargeable to cash. Posting is not done directly from the petty cash record. What other records are there of petty cash disbursements? (IOU slips) (odd chits) (petty cash vouchers with amount, payee, date, etc.)

26. Right. A bank account is safe and convenient because you are enlisting the services of a secure, professional and accurate agency for handling cash. Banks have savings accounts of various kinds as well as checking accounts, but you will more often be concerned with checking accounts.

27. To open a checking account, see an officer, file a signature card, with other identification and instructions, and make a deposit. Cash items like checks, drafts and money orders are accepted for deposit, subject to payments by their makers when sent throught the banking system

28. The signature card tells the bank who may sign checks on the account, and it has samples of approved signatures. Several different persons may be authorized by your firm to sign checks; and for checks of over a certain amount, it may be decided to require two signatures. What is required to open a checking account at a bank? (arrangement with bank office, signature card, first deposit) (a resolution by the board of directors only)

29. Yes. Checks and deposit slips or tickets are made in a variety of designs, with the bank usually supplying the deposit tickets, and for small firms supplying the blank checks as well. Notice that deposit slips require entry of the date of deposit, the title of the account, which is often just the name of the company, the account number assigned by the bank, and the amounts of money and checks being deposited.

30. Large numbers of coins being deposited should be in coin wrappers, and large amounts of currency should be arranged face up, small denominations on top. Checks should be in order listed, to save time. Checks may be identified by the assigned bank number, rather than bank or drawer's name. Who usually supplies deposit slips? (the firm) (the bank) (the FDIC)

31. Yes. Checks must be endorsed when deposited, to transfer title, guarantee payment, and provide record of receipt. While checks deposited or cashed by an individual should be manually signed, checks endorsed "for deposit only" by a company are often endorsed by rubber stamp. Such an endorsement is called "restrictive", since no part of it can be issued in cash, nor can it be transferred to a third party before clearing it.

32. When a deposit is made in person at a bank, the teller will acknowledge it by an entry in a small company passbook, or merely by stamping and initialling a carbon copy of the original deposit ticket, and returning it, or by a machine-printed slip. What would you call a check endorsement which includes "for deposit only"? (an invalid endorsement) (a resented endorsement) (a restrictive endorsement)

33. Right. When a deposit is made by mail, the checks are restrictively endorsed, and usually at least an original and a copy of the deposit slip are enclosed in the envelope. Deposits at the bank during non-banking hours are handled in a similar way. Then the bank clerk initials the copy or prints a slip which may be mailed back to the depositor.

34. About 90% of all payments are made by check. Blank checks are usually bound, numbered, printed with the company's name, and contain spaces for the date, the payee's name, the amount to be paid and the authorized signature. A check stub is usually attached for recording information which is retained in the checkbook or binder. Sometimes a carbon copy is made of the check or part of it.

35. Unless evident from the name of the payee, the purpose of the check may be noted on the stub, and sometimes even on the check. To avoid check altering, be sure to use a check imprinting machine, or write the amount in words, and don't leave any space between the dollar sign and the first digit. What immediate record is kept of a check? (numbered stub or carbon) (mental recollection) (marginal jottings)

36. Yes. It's illegal to issue a check for more than the deposit balance, but sometimes it happens through error, and in this event the firm's bank may refuse to pay it, and the bank and the payee may advise the firm. Often the bank will pay the overdraft and advise your company by phone or mail. In either case it is important to arrange for prompt payment.

37. Sometimes checks received from others are not honored, (that is, paid) by their banks, and returned to your bank, where they are charged against your bank balance. In this case, deduct the amount from your checkbook stub and credit the Cash account. Checks are processed faster today, partly because of the magnetic or optical "character recognition" equipment and procedure. This uses numbers which are assigned to the bank and to your firm's account printed at the bottom of the check. How would you decribe a dishonored check? (not honorable, has poor picture) (returned, not paid, charged back to you)

38. Right. A commercial bank not only accepts your deposits and pays your checks, but may also lend money or discount your firm's commercial paper, which is another form of lending. It also may collect for you the amounts of notes, drafts and other commercial paper due you, or charges for drafts written against your account in which case you are sent an advice of the credit to your account. Special services may also be provided, such as foreign letters of credit. It sends you a monthly statement showing checks, deposits and balances.

39. This statement should be "reconciled" with your cash accounts to find errors, if any. If any checks written have not been presented and paid, they are called "outstanding". Some recent checks or deposits may, of course be "in transit", or in the mail. Some small bank service charges may have been made by the bank, which must be entered into your accounts. But besides these, your company or the bank may have made a mistake, or a check may have been altered. This will show up in the checking procedure. What is it called? (a reconciliation of the bank account) (a conciliatory review of the checks)

40. Yes. Sometimes the balance on the bank's statement is different from the check stub balance because of the use of "counter checks" supplied by the bank for some special arrangement, or perhaps for interest charged when a loan is made, or for some other charge to the account. The cancelled checks and charge slips returned with the statement will help find the discrepancy. Sometimes it helps to have a separate bank account for payroll checks. How do organizations feel about cash accounting? (it's routine) (it's low priority) (it's critically important)

Payroll Accounting

1. Accounting for payroll is a key part of the total accounting process since it affects the legal and personal rights of all employees, and errors or omissions in this area may be considered serious by the employee, the government and by the organization.

2. The employee naturally wishes to be properly compensated and to have the proper deductions made to his paycheck. The state and federal governments require deductions to be then paid to them, or to legally required agencies, and the organization requires that accurate pay accruals, payments and deductions be made, and that the labor cost for various work classifications be reported. Is there a place for mistakes in payroll accounting? (Yes) (No)

3. Right. Regular employees who are under the continuous direction of an employer are paid wages or salaries in accordance with the understandings between the firm and the employee. Other persons may perform services, such as an independent outside public accountant, attorney, plumber, or electrician who performs specific service for a fee which may be arranged for such services.

4. "Wage" and "salary" are often used interchangeably, but if used differently, wage usually refers to labor compensation for skilled or unskilled hourly labor, while salary refers to compensation calculated on a monthly basis, usually for full-time administrative or professional services. What compensation would an outside attorney probably receive for a specific service? (wage) (fee) (salary)

5. In addition to basic wages or salaries based on hourly or monthly rates, supplements such as incentive bonuses, commissions, piecework premiums, overtime or profit sharing may be added to pay checks. Individual raises or reductions and general allowances for the cost of living or to meet labor contract provisions also affect gross payroll.

6. Compensation records begin with timeclock cards or other supervisor records for recording an employee's presence at a place of work. The Federal Wages and Hours Law requires that covered employees (but not so-called "exempt" managers and professionals) must be paid at a rate of 1 1/2 times the regular rate when they work more than 40 hours in a week. What are some of the other things which may affect payroll? (anti-trust laws, safety and health laws, Food and Drug Laws) (bonuses, commissions, profit sharing, cost of living, promotions, raises, piecework, etc.)

7. Right. In addition to the 40-hour law, labor contracts may require extra pay for weekends or special holidays. If an employee regularly is paid $4 per hour, he must be paid $6 per hour for those hours in excess of 40 worked in any established work-week, even if he failed to work 40 hours in the preceding or following weeks. If Joe Brown worked 42 hours in a week, he would be paid at the regular rate for 40 hours and at 1 1/2 times the rate for 2 hours. Sometimes this would be expressed as pay for 43 hours pay for 42 hours work.

8. Just because an employee's pay is stated as a monthly salary rather than an an hourly wage does not necessarily mean the employee is exempt from the Wages and Hours Law overtime provision, although nearly all exempt managers and professionals are salaried. Non-exempt but salaried employees are paid overtime by calculating an hourly equivalent (monthly salary times 12, divided by 2080 work hours per year) and then multiplying this rate by overtime hours times 1 1/2.

9. Employers are required to withhold part of employees earnings for federal and often state income taxes, and for social security tax. In addition, employers often deduct sums for health insurance, pension funds, union dues, credit union loans, savings bonds or charitable organizations. Who gets time-and-a-half pay for work over 40 hours a week? (no one) (all except "exempt" [Prof. - Mgr.] employees) (everyone)

10. Yes. Every employee must have a number assigned by the Social Security Administration. For those who don't, form SS-5 is used. The Federal Insurance Contribution Act (FICA) requires the deduction and withholding of a specified percentage, recently about 6%, of their earnings. Deductions for disability or unemployment benefits are sometimes made, although such costs are more often paid by the company.

11. In every case, earnings records must be kept of the name, address, account number, periodic and annual earnings, payment dates, employment periods, and the amounts withheld. If a new employee has no Social Security number, what must be done? (Wait 12 months, then write IRS) (Apply to SS Administration at once on Form SS-5)

12. Right. Each payroll check should have some kind of earnings and deductions statement attached. In addition there should be entries for the payroll on some kind of journal or register, and an individual file of earnings and deductions for each employee. These journals, registers and files can of course be maintained by a computer system.

13. The first record is usually a time clock card or slip, or a foreman's time book. The hours worked are totaled, multiplied by the hourly rate, then an allowance for overtime is made by adding the product of half the rate times overtime hours, which added to regular rate pay gives total gross earning. What are some other payroll records? (payroll journal or register, individual employee earnings records) (a collection of paycheck stubs, a basket of adding tapes)

14. Yes. The payroll journal or register will contain multiple columns for regular, overtime and gross pay, as well as the FICA, Federal income and perhaps other taxes, along with various insurance, credit union and other voluntary deductions. Where special columns are not provided, a general "other" or miscellaneous column, with space for explanation, is used.

15. In 1976, for example, 5.85% or the first $15,300 of annual earnings was withheld for FICA, and the federal income tax withholding schedule was provided, with separate tables for employees who claim various numbers of dependents. If Mark Johnson worked 85 hours during the first two **weeks of August at a rate of $4 per hour, what would he have earned, including overtime for 5**

hours? ($175) ($350) ($390)

16. Yes. In this period there were no bonus, incentive, or other special payments. Johnson has a non-employed wife and two children, so he had $27.30 withheld for federal income tax, in addition to the 5.85% withheld for FICA. How much is withheld for FICA? ($15.85) ($20.48) ($35.00)

17. Yes. In addition, he had deduction of $10 for Blue Cross, $5 for savings bonds, and $2 for the Civic Charities, leaving him a net pay of $285.22. The other employees have similar gross pay and deduction records entered on their checks and in the payroll register. How would you find the total amount of FICA tax withheld from all employees paid for the period-first two weeks of August?. (subtract the individual gross from the net total deductions) (total the FICA deduction column of payroll register [make footing])

18. Right. The payroll register is the record of the earnings of all employees for a pay period, and it provides a means for finding the total amounts of gross and net payroll, and the total of each of the taxes and other deductions. What record would you check if you wished to find several kinds of payroll information about an individual employee? (payroll register) (employee earnings record)

19. Right. Here is a part of Mark Johnson's earning record. He will probably not earn more than $15,300 during the year, so all of his paychecks will have FICA deductions. Notice the other deductions and extra earnings.

20. Every time that an entry is made in records accounting, a chance for an error exists. For this reason, various methods have been developed to provide carbon copies or other mechanical or electronic entries from which calculations and records may be made. Some are specialized bookkeeping machines, and others are specially programed, but general-purpose, data-processing equipment. This allows "one-time entry".

21. The payroll and bookkeeping machine, or computer, may be located at the company's business office, or it may be at a separate "service bureau" company which provide a record-keeping and data processing service based on original data supplied by the company in the form of <u>cards or tape</u>. In general, how can errors be <u>reduced?</u> (by "one-time" entry, error-checking procedures, use of data processing) (by sharp quill pens, extra high stools, low room temperature)

22. When bookkeeping machines, computers, or service bureaus perform the major payroll accounting steps, they are set up, prior to payroll preparation, with information about each employee. This includes name, address, number, pay rate, tax exemption claims, FICA status and voluntary deduction data.

23. At a given pay date, the regular and overtime hours worked, and any special or changed deduction charges are supplied by tape or punched card. These are fed to the computer "in house" or picked up to be prepared by the service bureau computer for preparation of checks and records.

24. In addition to reduction of errors, electronic accounting systems reduce accounting labor. The multiplying, adding and subtracting required to calculate gross and net pay for each employee and for the entire payroll is done automatically and at one time. What final manual step may be needed? (visual review, manual check signing) (button-pushing, errand-running)

25. Yes. Each employee must be furnished a withholding statement, for W-2, by January 31 of each year. This form shows the total amount of wages paid, and the total FICA, Federal income and perhaps state income taxes withheld. Which box shows the total wages received? (A) (B) (C)

26. Every employee has a social security account number, of course, and every employer has a Social Security Administration indentification number, too. This is entered on all reports which must be made to the Internal Revenue Service, which is the Federal tax agency, and other agencies. One copy of each Form W-2 is sent directly to the IRS by the employer along with the October-November-December tax return form.

27. Two copies of W-2 (three, in states with income taxes) are given to the employee, and one is retained in company files. W-2 forms for employees who leave the firm are sent to the employee within 30 days after termination. When do most employees get their W-2 forms? (about January 31) (about May 31) (about September 31)

28. Yes. Wages are expenses, and expenses are a temporary equity account. The wage expense account is increased by entering, as a debit, the gross earnings of the employees each pay period. In a larger organization, the wage expense account may be further divided into Production wages, Office salaries, Sales salaries and so on.

29. Amounts owed for FICA and income taxes withheld, and other payroll withholdings which must in turn be paid out are recorded in various liability accounts. You recall that accounts for expenses are increased by debiting. But how are liability accounts, like FICA, Taxes Due, or Income Taxes Withheld, increased? (by debiting) (by crediting)

30. Right. Withheld Income Taxes account, for example, is credited to record the taxes withheld from employees' wages. Later the account is debited when the government is paid these taxes. When you send such a payment, and debit Withheld Income Taxes Payable, what do you credit? (cash) (expenses) (losses)

31. Yes. Similar entries would be made in liability accounts such as Employees Insurance Payable, Employee Charitable Contributions Payable, and so on. In the case of FICA Taxes Payable, and perhaps some others where the employer makes joint contributions, the accounts are credited not only with payroll withholdings, but with the amounts the company must also pay as FICA tax. The later offsetting debits when these taxes and the company portions are paid, then include both amounts.

32. The payroll register, or the equivalent printout from payroll computer, provides data for a general journal entry like this. Wage expense is debited, and credit entries are made for FICA, Income tax, Insurance, other payables, and cash.

33. At the same time, a journal entry may be made for the payroll tax expense which you should consider to be incurred at the same time as the payroll expense. It usually consists of the employer's FICA tax, which exactly equals the total of employees' FICA taxes, and the Unemployment taxes, divided between Federal and State portions. This is how such a journal entry might appear.

34. In posting the journal entry for payroll tax expense, you debit the Payroll Tax Expense account with the total of FICA and Unemployment Taxes imposed on the employer, and credit the respective taxes payable accounts. What are they? (Local Property Taxes Payable, Sales Taxes Payable) (FICA Taxes Payable, Federal Unemployment Taxes Payable, State Unemployment Taxes Payable)

35. Right. Of course the FICA Taxes Payable account has already been credited with the FICA taxes withheld from employees' paychecks, so it now has equal amounts from employees and employers in its balance. The Federal and State Unemployment Taxes Payable accounts are credited when payrolls are made up; and later debited, or reduced, when the taxes are paid to the two government agencies.

36. Unemployment taxes are used by these agencies to pay compensation to persons who are unemployed, and for adminstrative costs. State laws vary, so you should study your local regulations. Typically, a company may pay about .3% to the Federal agency, and about 2 or 3% to the State agency.

37. FICA and withheld employee Income taxes must be paid to the Federal Reserve Bank or other bank depository each month, or for each payroll period, for larger accounts. Final payment in each quarter may be sent directly to the IRS. A Form 450 depositary receipt is sent in with the payments to be validated and returned to you. A Form 941 is used for quarterly tax returns. What taxes are being reported by Form 941? (FICA taxes on employees, employer, Employees' withheld income tax) (Excise taxes for products, Excess taxes on profits)

38. Yes. Notice that you first enter the Federal income taxes withheld, subject to previous adjustments, then the total wages and FICA taxes on them. The total of these two kinds of taxes is then shown as paid by previous deposits and the accompanying payment.

39. Here are "T" accounts for Wage and Payroll Tax Expenses, and FICA and Employees Income Taxes Payable, and Federal and State Unemployment Taxes Payable. Notice how each of them are increased and decreased.

40. Finally, even where records, checks and reports are largely entered, calculated and recorded by computer, there is usually a visible document which is first signed by a supervisor before a pay check is issued to an employee. What is it? (Computer fanfold printout of corporate shareholder records) (Time clock card, work slip, or foreman's time book)

Purchases and Sales

1. A simple cash-flow accounting system is useful for an individual's personal records, or for a small personal service enterprise, but organizations which get revenue from sales of goods held for a while in inventory need a method to accrue the effects of such sales, and the effects of the purchase and handling of such goods, since they are usually sold and purchased by credit, rather than cash.

2. A firm which on March first had $10,000 worth of inventory on hand, and received $6,000 worth from its suppliers, returning $1,000 worth for various reasons, had a total of $15,000 of inventory it could sell. If it sold $12,000 of such merchandise, which originally cost $8,000 before handling, service and sales expenses, received $10,000 in cash for previous and current sales, paid $7,000 for previous and current purchases, and spent $2,000 for certain expenses during the month, what did it need? ($1269.72 to cover losses) ($761.12 to meet payroll) (a good accrual accounting system for purchases and sales)

3. Right. When purchase and sale of goods make up a substantial part of a firm's operations, and especially when credit is involved, one can't just look into the till, or the bank balance, and tell whether a profit or loss was made, and how much. Profit, or loss, is the remainder after all costs, consisting of expenses and purchase costs, have been subtracted from the amount of total sales.

4. In a simple merchandising operation which does not manufacture, modify, or add directly very much value to the goods purchased and sold, except by storage and selling effort, the direct cost of the goods which are sold is simply determined for a month by adding the purchases during the month to the net decrease in inventory. If there's an increase in inventory, the cost of goods sold is purchases <u>minus</u> inventory <u>increase.</u>

5. Another way of saying this is to say that cost of goods sold equal purchases, plus beginning inventory, less ending inventory. If there were no change in inventory, the cost of goods sold would equal what . . . ? (total sales revenue) (purchases) (profits)

6. Yes. Of course if you wished to look at matters in a sort of time sequence, you could also say that cost of goods sold equals beginning inventory plus purchases, less ending inventory. "Beginning" or "ending" inventory means of course the total value of merchadise inventory at the beginning or end of the month or other accounting period.

7. Also "purchases", in the cost-of-goods-sold equation, means "net purchases"; that is, total purchases minus goods which are returned to suppliers for some reason, whether they were received during the period, or earlier. You will find later that "net sales" has a similar return-for-credit feature. How could you describe cost of goods sold? (net purchase + decrease of inventory, or Purch. + [Beg. Inv. - End. Inv.]) (beginning inventory times purchases, minus returns, divided by........)

8. Yes. Remember, profit is what remains after expenses and costs of goods are subtracted from sales. If only cost of goods sold is subtracted from sales, you get an intermediate amount called "gross margin", from which you then also subtract expenses to get profit. Sometimes the difference between sales and cost of goods is called "gross profit" instead of "gross margin", but since this is often misleading, always use "gross margin".

9. Don't forget, gross margin is the difference between sales and cost of goods sold. In turn, cost of goods is made up of purchases, plus beginning inventory, minus ending inventory. Also remember, both sales and purchases are "net", or less any returns for credit.

10. Let's say sales were $52,000 less $2,000 returned from customers, or $50,000 net. If the purchases were $31,000, less $1,000 returned to suppliers, net purchases were $30,000. If beginning inventory was $26,000 and ending inventory $24,000, inventory decreased by $2,000, and cost of goods sold was $32,000. What was the gross margin? ($18,000) ($22,000) ($30,000)

11. Yes. You must obviously keep accounts for purchases, sales and inventory. For management review, separate accounts for purchase returns and sales returns are often used. Like revenue, sales and purchases are temporary equity accounts, and since owner's equity is considered temporarily decreased by the cost of purchases, the purchase account will be debited to record the cost of the goods purchased. The offsetting credit entry for a purchase will normally be in accounts payable, but sometimes you might credit what other account instead? (Notes Receivable) (depreciation) (cash [when purchase was for cash])

12. The purchase account may also contain entries for freight or postage which directly apply to the goods received. A "Purchases, Returns, and Allowances" account is set up to record credit entries for goods which are returned to suppliers for some valid reason. The offsetting debit for Purchase Returns is usually to Accounts Payable. If a purchase were returned to a supplier for an immediate refund (which is unlikely), what is the offsetting debit? (profits) (interest) (cash)

13. Right. Purchases are often made by numbered "purchase order", and when the goods arrive, they may be accompanied by a "delivery slip" but the purchase transaction is completed when goods are delivered and a "purchase invoice" is received. The invoice is numbered and dated, usually refers to the purchase order number and date, lists the goods and their prices, and the total amount of the purchase.

14. A lot of money is paid out for purchases, so someone must check each invoice for the proper amounts, prices, extensions and totals. A bookkeeper may check the arithmetic and usually the correspondence between the invoiced items, their prices and the original purchase order, but some merchandise specialist must check to be sure the proper goods and quantities have been received. And a third person may eventually be involved. Who is this? (person who gives final approvement for payment or signs check) (person who checks to be sure the colors match perfectly)

15. Yes. The initials or signatures of these persons should be on the invoice, in a rubber-stamped form, or an attached slip for the record. The invoice received for a purchases may also be assigned a special working number by the accounting department. This may be especially useful when the invoice is for more than one purchase order or for part of a purchase order.

16. Most purchases of merchandise are made on a credit account. When purchased goods and the related invoice arrive and are checked off, what entries are made? (debit Accounts Payable, credit Purchases) (debit Purchases, credit Accounts Payable)

17. Right. Accounts Payable is a liability account, of course, and the managers need to know what amounts are owed, to whom, and their total. Money owed and later paid to suppliers is documented by an unpaid invoice file and an invoice record, which may be chronological, or classified into individual accounts for major suppliers and a sub-account for miscellaneous suppliers; all in the ledger.

18. A Merchandising business may use a special original entry record called a "purchases journal" instead of entering purchases in a two-column general journal or a combined journal. Each entry must record the date that the invoice is received, its number, the supplier and the amount. What other information might be listed? (purchase order no., goods purchased, assigned invoice no.) (street address and phone number of supplier)

19. Yes. Like other journals, entries from the purchases journal are later posted to the proper accounts in the ledger. This may be done only once a month by a "summary posting" procedure in which the total of purchases are debited to the purchases account and credited to accounts payable.

20. If separate accounts are maintained for important suppliers, individual transactions may be posted directly from the invoices, or from the journal. What is a term used for a single monthly posting from a purchases journal? (overall posting) (summary posting) (grand posting)

21. Purchase invoices from suppliers which don't have separate ledger accounts should be filed at once in an unpaid invoice file, in accordance with due date. If a discount is offered and will be taken, the effective due date is the discount date, rather than the net payment due date.

22. Invoices from a supplier should be paid in order, and each paid in full. If payments are made out of order or in part, special notation and arrangements should be made. These are potential causes of errors, so be careful. After payment, invoices in the miscellaneous file may be arranged alphabetically.

23. Like the purchases account, the sales account is a temporary equity account for sales revenue. Sales are credited to this account, since, as you recall, increases in equity are made by credit entries. What do you think would be the offsetting debit entry for a credit entry to sales revenue? (Accounts Payable) (Notes Payable) (Accounts Receivable [or cash])

24. Right. Some of the sales will be, in effect, cancelled out by the return of goods from customers. Such transactions, if they were quite rare, could be debited directly back to the sales revenue account, but a merchandise firm with a large number of sales will wish to account separately for sales returns and allowances. Separate reporting of sales and returns will help analysis of sales operations. The sales returns account is debited to record the returned goods.

25. For every sale, some sort of permanent initial record is made. In a supermarket it would be the cash register tape; for most other sales of goods, it would be a handwritten sales slip or ticket, usually in duplicate or triplicate. The customer gets a copy, and the accounting department gets the original, which is usually signed by the customer, if it is a charge sale.

26. The sales slip or ticket is imprinted with the firm's name and address, a serial number, and spaces for the customer's name and address, date, cash or charge, department, person receiving goods, a description of them, their price and total amount of sale. If the goods are returned, the sales slip copy must be presented. What account would be posted for goods brought back by customers? (Sales Returns and Allowances is debited) (Purchases is credited)

27. Yes. Most retail sales are subject to a city or state sales tax proportional to their amount in even percentages, such as 2%, 3%, 5%, and so on. The salesman does not charge fractions of a cent, so a table is provided showing the number of cents charged for various fractions of a dollar.

28. This table for charging 4% retail sales tax for amounts less than $1 should be posted and probably memorized. What tax should be charged, at 4%, on a sale of $3.25? ($.12) ($.13) ($.14)

29. Yes. Reports of sales taxes collected, due and remitted are required, usually each month. Until it is paid to the state or city, it is a liability, entered by credits into the account "Sales Tax Payable". What entries are made as a result of paying the tax to the city or state? (debit Accounts Receivable, credit Sales Tax Payable) (debit Sales Tax Payable, credit Cash)

30. Right. Sales taxes are often considered a nuisance by merchants, but they are an effective and in some respects efficient means of collecting taxes. But bookkeepers for such firms must remember to adjust for returns and allowances, for sales to other firms for resale, or to tax-exempt customers like schools or to out-of-state customers which are exempt from sales tax. In some states a small allowance is made to the merchant for the bother of sales tax collection.

31. When posting sales subject to sales tax, you would normally debit Cash or Accounts Receivable for the total, and credit Sales and Sales Tax Payable for the separate amounts. A sale of $104 including tax might be debited entirely to Accounts Receivable, (or Cash); and credited $100 to Sales and $4 to Sales Tax Payable.

32. Some states allow merchants to credit the entire amount including the tax to the sales account then once a month enter a calculated amount into sales tax payable. This might, for example, be 4/104 ths of the total of sales plus taxes imposed. What is the usual posting of a sale? (debit

Accounts Receivable [or Cash], credit Sales [and Sales Tax Payable]) (debit Sales, credit Revenue Taxes)

33. Yes. All cash sales slips must be carefully filed during a business period, and the charge sales slips, which amount to invoices to the customer, requiring payment, are retained in a set of files of unpaid accounts.

34. Cash flow management is often critical to a business, so a currently posted summary, the ledger account "accounts receivable", is used. This account should be continually debited for sales and credited for payments received from customers. At any time, the net debit balance is the total amount receivable from customers.

35. Sales, like purchases, may have their special journal, the Sales Journal, for credit sales. Each month the total sales are debited to Accounts Receivable and credited to Sales. Sales journals usually have two credit columns; one for actual sales and one for sales tax. What are typical journals for a merchant? (always a two-column general journal only) (combined cash journal, purchases journal, sales journal)

36. Right. The Purchases Journal lists credit purchases chronologically with dates, an internally assigned invoice number, supplier and amounts. At the end of the period the Purchases Account in the ledger is debited and Accounts Payable credited. Where are cash purchases first entered in the books? (combined cash journal) (sales journal)

37. Yes. The Sales Journal lists credit sales chronologically,with dates and internally assigned sales slip or ticket numbers, customers, and amounts of sales and sales tax. At the end of the period, the Accounts Receivable account in the ledger is debited and the Sales and the Sales Tax Payable accounts are credited.

38. A trial balance is taken by footing all the general ledger accounts and adding debits and credits, as usual. A schedule of Accounts Receivable and a Schedule of Accounts Payable can be made up from the respective ledger accounts showing only the unpaid balances and the customer and supplier names.

39. After posting, checking by trial balance, and preparing monthly reports such as total sales and schedules of Accounts Receivable and Payable, to find profit or loss you must obtain the total direct cost of the goods sold, and the related indirect costs (expenses) for the month. The cost of goods sold is of course the net cost of purchasing including freight during the month, plus or minus the decrease or increase of merchandise inventory. The expenses are made up of things like salaries, rent and utilities.

40. At the end of an accounting period, the asset account "Merchandise Inventory" which shows merchandise which should be on hand, is debited to increase its balance (or credited to decrease it). The offsetting entry is in a temporary equity summary account used for showing the profit or loss during the period. This summary account will collect the entries from purchases and sales revenue. How could you show cost of goods sold? (C.G.S. = Sales - Purchase + Tax)

Notes and Interest

1. When every family produced its own goods and services, no trade was involved. When production became specialized, trade occurred and money was needed. When an economy becomes complex and highly productive credit is used in place of money.

2. We say "charge it", or "put it on my account", or "use my credit card" to refer to a transaction which does not involve immediate exchange of money, but the obligation to pay the money in the future. Such credit accounts usually are intended to carry charges for only a few weeks, but additional arrangements may be made to extend payments for longer periods. Why do we need credit? (to avoid payment for goods and services) (to ease trade)

3. Right. Trade receivables are the accounts that result from sales of merchandise, while a promissory note reduces to writing the terms agreed on by a buyer and a seller. This makes one firm's note receivable another firm's note payable.

4. A promissory note is a signed promise to pay a sum of money to someone, either on demand or at a specific date. What could you call a general agreement to pay for credit charges at monthly intervals? (debit exit) (credit account)

5. Right. Some notes call for payment in a specified number of days after they are made. Other notes may call for installment payments beginning on a certain date. These payments are usually monthly. The characteristics of a promissory note are that it is; first, unconditional; second, it's a signed promise; third, to pay a sum of money; fourth, to some specific person; fifth, on demand or on a given date.

6. Notes usually provide for the payment of interest. The use of money is worth money, which we call interest. If your company had extra cash, it could invest in a U.S. Government note, for perhaps 60 days at 6%. This would return a 1% interest payment. In 60 days, for example, the use of $10,000 would pay $100 in interest.... What are the characteristics of notes? (unconditional, signed, specific amount, person, payable on demand or a given date) (general, conditional unsigned, vague, contingent)

7. Yes. If your company needed extra cash, for example because its customers bought on credit, your company might have to borrow and pay interest for the use of the money to a bank or other lender. If your customers don't pay cash or pay accounts promptly, sales prices would likely be slightly higher to pay for the use of the needed money.

8. Companies sometimes charge interest on unpaid accounts receivable to make up for the foregone opportunities to invest the cash it would have otherwise had, or the interest is must pay. Is this fair? (Yes) (No, and it's always illegal)

9. Yes. In the same way, notes usually include a provison for interest as a charge for the use of money. You probably already know the formula for the calculation of interest. It is the princi-

pal times the interest rate times the time period. For example, the interest on $1,000 at a rate of 6% for six months is equal to $30. To avoid confusion, we will usually say "interest rate" for the annual rate of interest, and "interest paid or earned" for the amount of money paid or earned.

10. Time is usually stated as a fraction of a year. Remember, for simplicity, the business world assumes that the year has 360 days. If your company borrowed some money for 90 days at an interest rate of 8%, how much interest would it pay? (8% of $10,000) ($400) (2% of the amount borrowed)

11. Right. Here is an easy way to find interest on some notes. For example, when the annual interest rate is 6% and the time period is 60 days; since 60 days is 1/6 of a year, the annual interest of 6% yields 1% of the principal in 60 days. Don't forget, interest rates are nearly always given in yearly rates. So, as a shortcut, 6% interest for 60 days can be calculated by moving the decimal point in the principal amount two places to the left.

12. Interest at 12% for1/12 of a year, or 30 days, would also be 1%. So would 9% at 40 days, or 8% at 45 days. For example, find the interest cost on $5000 at 6% for 60 days. Moving the decimal point two places to the left gives $50. What would you pay, including interest and principal, at maturity? ($50) ($5000) ($5050)

13. Right. The shortcut interest technique can be used for other interest rates or time periods. For example, interest for 30 days is one-half of 60 days interest and at 6% it would yield 1/2 of 1%. If an 8% note earned 1% interest in 45 days, what would a $1000, 8% note earn in 90 days? (1%[$10]) (2%[$20]) (8%[$80])

14. Yes. Here is a 90-day note which was originally made on April 15. When will it mature, and need to be paid? Don't forget, although April and June have 30 days, May has 31 days. (on June 15) (on July 14) (on July 15)

15. Yes. This note results from a $1,000 sale by the ABC Company to the Smith Company. Look at the entries on the books of each party to the note

16. The entry on the left would be made to ABC's books, the one on the right on Smith's. Notice that ABC's receivable is Smith's payable. On July 14, Smith must pay $1010, the maturity value. In addition to entries in cash and notes receivable, ABC will credit interest revenue, and Smith will debit interest expense when the note is paid.

17. Here the XYZ Company pays a $500 note plus $5 interest to the PDQ Company. To make entries to record this event for both firms, notice the XYZ's interest expense is PDQ's interest revenue. A firm may accept a note receivable in settlement of an overdue account. Two reasons for this are that a note can provide for interest, and it is better evidence of the obligation.

18. This entry reflects the acceptance of a note receivable in settlement of a delinquent account.

If the debtor is unable to pay the note on its due date, this should be recognized in the accounting records. The obligation may be returned to the accounts receivable account and the dishonored note receivable written off with a credit.

19. If the debtor agreed to pay interest on the note, the ten dollars interest earned is recorded with a debit to accounts receivable and a credit to interest revenue. The two entries may even be combined into a single entry. What entry would be made to notes receivable? (a debit for principal and interest) (a credit for principal [to write off note])

20. Right. To record the dishonor of a $600 note receivable and $9 accrued interest, your entry should look like this .... A promissory note with certain characteristics is a "negotiable" instrument. This means that the rights to a negotiable instrument may be transferred to another person by a simple endorsement on the back of the instrument.

21. This negotiable note matures in 60 days from April 15. When the note was accepted on April 15, this entry was made. The maturity date or due date is June 14, which is sixty days from April 15, the date when the note was made. The maturity value of the note is $606, which is the total of principal and interest that must be paid on the due date.

22. If every month were exactly 30 days long, a 60-or90-day note issued on, say April 7 would be due on June 7 or July 7. But February is 28 or 29 days long, and January, March, May, July, August, October and December are 31 days long. So a 90-day note issued on April 7 would be due July 6 because of one intervening 31-day month. When was a 90-day note issued January 10, 1976 (a leap year) due? (April 8) (April 9) (April 10)

23. Yes. Bankers often use small electronic calculators or more often, reference books, to find the due date and interest cost for notes issued on a given date at a certain interest rate. This saves manual arithmetic, and probably reduces errors.

24. On April 30, the company had an unanticipated need for cash. It wanted to convert the note to cash without waiting for the maturity date. So it transferred the note, by endorsement, to a bank and got money in return. This is referred to as "discounting" a note to a bank. Why do you suppose is is called "discounting"? (because the bank pays less than principal and interest to maturity) (because the bank doesn't count any interest)

25. Right. The bank must wait forty-five days until the note matures. This is the discount period; in other words, the bank is purchasing a note on April 30 that will mature in forty-five days and pay $606. Naturally the bank expects to earn something for making what amounts to a forty-five day loan.

26. In this case the endorsement by the company carried with it a liability to pay the note in the event that the maker defaults. This obligation is sometimes referred to as a "contingent liability" What does this mean? (If maker of note doesn't pay, bank loses) (If maker of note doesn't pay, endorser must pay bank)

27. Right. The bank usually subtracts its fee for purchasing a note from the maturity value, the value of principal and interest. The amount subtracted is known as the bank discount. The remainder, known as the proceeds, is paid to the firm that sells the note to the bank.

28. Let's say the bank charges a discount rate of 6%. The maturity value, times the discount rate, times the discount period, yields a discount of $4.55. The company will receive the proceeds of $601.45, which is the maturity value of the note, less the discount charged by the bank. Remember; principal times interest rate times the term of the note yields the amount of interest. When the interest is added to principal, we get the maturity value. When a bank subtracts its interest from a discounted note, what is the name for the money paid to the company? (the proceeds) (the imbalance) (the contingency)

29. Yes. Maturity value times the discount rate times the discount period calculates the amount of the discount. And the maturity value less the amount of discount yields the proceeds from discounting a note. Notice the similarity between the interest and discount calculations.

30. We could say that discount is merely interest paid in advance. Remember, interest is added to principal to get maturity value, discount is subtracted from maturity value to arrive at proceeds. When a note is made to a company which is later discounted to a bank, what happens? (interest is merely added to principal) (discount is merely subtracted from principal) (interest is added to principal, then discount is subtracted from this maturity value)

31. Right. The note that was discounted by the company will yield proceeds of $601.45, calculated as shown here, so in effect, the bank is charging the company $4.55 for a forty-five day loan of $601.45. The bank will collect $606 at maturity. The proceeds to the company are debited to its cash account. When the proceeds exceed the principal amount of the note, interest revenue is credited, to balance the entry.

32. If the proceeds are less than the principal amount, interest expense must be debited, to balance the entry. This means that when proceeds are greater than principals, there is interest revenue. When proceeds are less than principal, interest expense is recorded. When a note is discounted, what happens? (There is always net interest revenue) (There is always net interest expense) (Either revenue or expense, depending on how long note was held and the interest and discount rates)

33. Right. Don't forget, "discounting" a note receivable is the process of selling a note receivable to a third party. The face value, plus 6% interest for 60 days, equals $1,010 maturity value of this note. This note is discounted at 6% on June 30, which is 30 days before it is due. The maturity value less the bank discount of 6% for thirty days, equals $1,004.95. The journal entry to record the discounting of the note should record interest revenue or $4.95.

34. The note discounted by the company matures on June 30, and hopefully the maker of the note will pay the bank on the maturity date. But, if the maker doesn't pay, the bank will require

the company to pay, since it is the endorser of the note. When the company pays the maturity value of the note to the bank, it opens an account receivable from the original maker, to record the dishonoring of the note. How much would be entered into the account receivable? ($1000) ($1004.95) ($1010)

35. Right. A credit account usually has an agreed payment time or period. When a customer wishes to extend the period for payment, he may issue a promissory note for this purpose. Occasionally a company may lend cash to someone, perhaps an officer or employee, and accept a promissory note as evidence of the loan. How would this be shown in the journal? (debit cash, credit accounts receivable) (credit cash, debit notes receivable)

36. Right. A customer may issue a note upon the purchase of something, say equipment, in which case the transaction is never recorded into Accounts Payable, unless the note is dishonored. The customer debits, or increases, his asset account, "equipment". What does the customer credit? (cash) (accounts payable) (notes payable)

37. Right. Typical transactions which involve notes receivable are notes which are received in (a) extending a customer's credit account, (b) for merchandise or other assets sold, or (c) for a cash loan to an employee or other person; and for notes which are collected, dishonored, discounted or renewed.

38. Typical transactions which involve notes payable are: issue of note for merchandise or other asset purchased, note issued to extend an account payable, or a note issued for a cash loan, and the payment or extension of a note payable when it matures.

39. A properly drawn promissory note is a "negotiable instrument". It should be a written and signed promise to pay made by one person to another specific person a specific sum of money on a certain date or on demand. It should bear interest. What can be done with a negotiable instrument? (used to make outrageous profits) (used to paper the walls) (can be discounted for cash)

40. Right. Credit is an important and useful concept which must be carefully used. A promissory note is formal evidence of debt which must be honored, and never be treated casually, for it is enforceable by law. As in other accounting matters, the recording, classifying and summarizing of credit accounts must be performed carefully and accurately.

Inventory and Expenses

1. In accrual accounting systems, sales stock and other assets which are used, sold or expended in one period, but paid for in another period, are properly charged by increasing or decreasing asset, liability and expense accounts, independently from cash.

2. Salaries, interest and taxes payable are examples of expenses which are typically accrued before they are paid for. On the other hand, goods held in inventory for sale, and certain prepaid expenses such as rent and insurance, are often paid for before their sale or use. They are still considered short-term assets providing relatively early benefits. How would they be listed? (current assets) (fixed [long-term] assets)

3. A merchant manufacturer, or even a service business which also sells parts, must account for its saleable inventory of goods at the end of each fiscal year. The obvious way to do this is to count the kind and number of items on the shelves or in cartons. What would you think this process is called? (listing a theoretical inventory) (taking a physical inventory) (leaving a book inventory)

4. Yes. In this way the quantity of goods on hand at a certain time is positively determined. You can easily imagine how important this is, since many companies have experienced severe problems because of financial records which did not reflect the actual amount and value of the physical inventory.

5. Since taking a physical inventory is time-consuming, it is usually performed only once or twice a year. It is most conveniently done, of course, when it is smallest, and this usually is the case in certain times of the year, due to seasonal factors. Since this is not always on December 31, some firms establish their business, or "fiscal" year, periods to end on some other date.

6. Taking inventory must be well-organized and efficiently performed, or it will be an endless, expensive task, and may contain serious errors. Traditionally, it is done in several steps. First a "caller" looks at the goods on the shelf, and "calls out" the item names and quantities to another person who enters the information on a list. What is the name for the yearly business period selected by a firm for its convenience, especially for inventory? (fictional year) (physical year) (fiscal year)

7. Right. Nowadays the inventory may be called out by an employee who uses a tape recorder, rather than to another person standing by. In either case it is more efficient than the caller making the entries himself as he looks through the goods. After entry, goods are "costed" and "extended".

8. An inventory sheet will show the word "Inventory", a date, page number, department, location, caller's name and the names of those who enter the information, add the prices, and multiply to obtain the value of the items. How would the typical steps be described? (called, entered, costed, extended) (noted, corrected, divided, stacked, replaced)

9. A physical inventory is expensive and often disruptive to the work of others, so it is important to perform it quickly. Another reason for quickness is that errors in counting or failing to count goods in the process or reception or shipment (in transit) should be avoided.

10. When in doubt, all items physically present should be described, counted and listed, with time, location, situation and labeling included, with comments as to possible effective ownership. The firm owns all goods from suppliers which are present and have been billed, and goods to customers which are present and have not yet been charged to them. Why should inventory be performed promptly? (to meet IRS requirements) (to avoid overtime) (to reduce errors, time, cost, disruption)

11. After inventory has been called and entered, a price must be assigned. This is "costing". If some items of the same kind were purchased at one price, some at another, and new purchases would have to be at still another price, a question arises as to how to assign the cost.

12. If all items of a kind are alike, it is impractical to cost some of them at one amount, and others at different amounts. If one-horse power motors which ordinarily sell for $100 have been purchased, some for $64 and some $68, they may all be priced at $64, $68 or at a weighted average, say $66. Or if they are now available at $60 or $70 from suppliers, competitive or sales considerations might call for the use of one of <u>these</u> figures. Which price would be absolutely correct? (Precisely $60) (any of them, depending upon circumstances) (Exactly $70)

13. Yes. During a period of a year, 5000 units may have been purchased, with 1000 left on hand, in inventory, at year end. If at the beginning of the year the items were purchased at $64, and near the end at $68, it might seem reasonable to assign the latter value to inventory. This procedure is called "first-in, first-out" or "fifo" costing.

14. Fifo costing, because of its apparently reasonable nature, is widely used. The older goods are usually sold first, for obvious reasons. Further, the latest price usually best represents the price of additional purchases when necessary. Also, this is the traditional way, and the basic values of accounting are based on tradition and consistency with previous practices. What does "fifo" stand for? (first-in, first-out) (fast-in, fast-out) (fall-in, fall-out)

15. Yes. But let's say you owned a small oil company, and you paid $2 per barrel for oil until December, during which you bought a little oil at $12 per barrel, (a bargain when others were paying $14). But to refine, process, store and ship it, you must keep a 180 day supply. Should you use the fifo method and cost your inventory at $12, showing an unrealized profit and paying income taxes on it, when prices might soon drop to $6 in the coming year, say due to price controls?

16. In such a situation, you might prefer to say that your cost of at least some of the goods sold recently was at the last, higher purchase price. This would lower your declared profit, and lower your income tax liability. If the tax regulations allow it, as they usually do, you might chose this method. What do you think it is called? (last-in, first-out["lifo"]) (highest-in, never-out ["hino"]) (recent-in, next-out["rino"])

17. Yes. Fifo, (first-in, first-out) usually represents the actual facts and is traditional. In periods of inflation, lifo, (last-in, first-out) is more conservative and saves taxes. If 1000 motors at $62 were beginning inventory, 1000 were purchased at $64, 1000 at $66 and 1000 at $68, and at the final inventory there were only 2000 in stock, fifo would assign them an average value of $67. What value would be assigned using the lifo system? ($60) ($63) ($67)

18. Yes. You might say that there were, during the year, altogether 4000 motors "available" for sale, with an average cost of $65, and that a reasonable value for the ending inventory would thus be $65. This is called "weighted-cost averaging". This method, despite its reasonableness, doesn't satisfy the proponents of either fifo or lifo.

19. For a refinery, steel mill or coal plant, with a process which requires a constant inventory of several months' supply, this minimum inventory is a little like an original capital investment which is never sold, and should never be marked up in price. What kind of costing is indicated in such a case? (fifo) (weighted averaging) (lifo)

20. Right. The same model of calculator you bought for $20 to sell at $30 may now be purchased at $5 to sell at $10. If you are now selling the calculators you originally purchased at $20 at a loss for $9.95, what would be a prudent value for your remaining inventory? ($5) ($10) ($20)

21. Accountants are rather conservative. The "conservative rule", sometimes called the "principle of conservatism" is a common choice. This rule provides for all reasonable losses which can be anticipated, but does not anticipate gains.

22. In applying the conservative rule to inventory costing, we could use the "lower of original or replacement cost." This would mean $2 oil or $5 calculators in inventory, with the costs assigned to the goods which were sold being higher, and the indicated profits lower than otherwise.

23. If a refinery has a stock inventory originally priced at $1 million and other assets worth another million dollars, the entire facility may be worth $2 million as a going business, but if it were closed down, the oil inventory in process may actually be worth $5 million at current prices! What do we call the policy which calls for pricing at the lower of market or original costs? (radical rule) (liberal rule) (conservative rule)

24. Right. Interim estimates of the costs of goods sold and in inventory are made without taking inventory, for interim reports such as monthly or quarterly. One way to make these estimates is by determining the average percent of total sales which has historically been made up of cost of goods sold, and what percent was gross margin.

25. For example, if cost of goods sold has been 60% (ranging, say, between 58% and 62%) of sales in the past, with a gross margin of about 40%, you could estimate the cost of goods sold on sales of $10,000 as $6,000, with a margin of $4,000, before expenses and taxes. Why is it necessary to make such estimates of the cost of goods and remaining inventory? (for interim physical reports when physical inventory is not taken) (estimates are more accurate than counting) (to

26. Yes. The method of estimated percentage allocation to cost of goods sold and gross margin can be useful in showing what the actual inventory should be at any time. Any material differences between the "book inventory" and the actual inventory should be cause for concern and investigation.

27. Another method of allocating goods sold and inventory cost uses the ratio of current and historical wholesale-to-retail costs. A third method employs "perpetual inventory" records which indicates the inventory which should be on hand by recording additions and reductions as a result of purchases and sales. This kind of book-inventory system is only economical, however, for inventory which consists of rather valuable units, such as television sets or automobilies.

28. As the cost of handling data is reduced by means of electronic data processing, it will be feasible to keep account of less expensive items. What are some ways of making interim estimates of cost of goods sold and merchandise inventory? (educated or trained guess, bin tally cards) (taking endless physical inventory) (percent cost-allocation, wholesale-to-retail ration, perpetual inventory)

29. The formula for cost of goods sold, you will recall, is the purchases plus inventory decrease, if any. The complete formula is: C.G.S. equals purchases, plus beginning inventory, minus ending inventory)

30. After finding the gross margin, expenses must be subtracted to obtain profit. Some expenses are relatively constant; salaries, utilities and the like. But other expenses occur or must be paid all at once, although they apply to operations which extend for a longer period. What do you think are examples of these one-time expenses? (monthly telephone bill, water and sewage bill, secretary's wages, depreciation) (insurance premiums, large-quantity supplies, advertising calendars, interest discount)

31. Right. Separate accounts may be set up for a number of assets like office supplies, postage stamps or meter tapes, store supplies like bags and wrapping paper, catalogs and other advertising supplies, insurance premiums, prepaid interest and the like. But several of the smaller assets of this non-merchandise type are often combined in a single Prepaid Expenses account.

32. There are two ways of considering expenses which are in part prepaid. First, if much of the cost may be represented by unused assets at the end of a period, they may all be set up as the asset "Prepaid Expenses" when paid or charged for; then at the end of the period their remaining value is retained, and the balance, the used-up part is charged to the proper expense account. This is the "asset method" for accounting for prepayments.

33. The second way charges all cost to expenses as incurred, then like the first method the remaining value is determined and temporarily transferred to a Prepaid Expenses asset account. The process is different, but at year-end are the results the same? (Yes) (No)

34. In the asset method of prepayment accounting, if one day the firm bought $500 worth of paper, envelopes, ball-point pens and other office supplies, $600 of shipping bags, boxes and oils, cleaners and other store supplies, $800 of special catalogs and circulars, $300 of stamps and postage meter deposits, and paid $400 for a new insurance policy, how much would be entered as assets, and how much as expenses on that first day? ($26000 Prepaid Expenses, [asset] 0 Office Expenses) (1300 Prepaid Expenses, [asset] 1300 Office Expenses) (0 assets, 2600 Expenses)

35. Yes. But if the expenses method of prepayment accounting were used, all $2600 of payments would be expenses. Then, as with the asset method, at the end of the accounting period the remaining value of each item paid for would be calculated or inventoried, and expenses would be reduced by this amount.

36. In order to make the expense method correct from period to period, the prepaid expenses asset account must be again expensed on the first day of the new period, and included along with the amount of expense payments in the new period.

37. Postage stamps, catalogs and envelopes can be counted and valued, but the value of unexpired prepaid insurance must be calculated by subtracting that portion of the entire prepaid period of the insurance policy (which might be 12 months) which has expired at the end of the accounting period, (which might be 3 months). If $400 were prepaid on October 1 for a year's insurance, what would be shown on December 31 as the expenses and remaining asset? ($300 Insurance Expenses, $100 Prepaid Expenses[asset]) ($100 Insurance Expenses, $300 Prepaid Expenses [asset])

38. Most firms have several insurance policies; for fire, casualty, compensation and the like. They are important documents and their details should be quickly available. Important data on the insurance company, date and number of policy, expiration date, total premium and monthly cost can be entered on appropriate lines in an "Insurance Policy Register".

39. The cost of taking physical inventory of office supplies, accounting for inventory and accounting for prepaid expenses should be balanced against the benefits of having such information. In some cases these benefits may be trivial, since the costs are evenly distributed among accounting periods, or are not large compared with other costs. In this case, what could be done? (Expense the costs as payments are made) (nothing) (accrue everything until December 31)

40. Yes. Goods for sale, supplies and other prepaid expenses, are often purchased or paid for in an accounting period before the one they benefit. But they are not held as an asset for long, like equipment and other fixed or long-lived assets, so they are considered current assets. In the next program you will learn about accounting for fixed assets.

Fixed Assets

1. Current assets are expected to be sold rather soon. They are "short term" assets. "Long term" assets, also called "fixed", "plant" or "capital" assets, are to remain in service for several years. Although sometimes assets are hard to classify, most current assets, like cash, accounts receivable and merchandise inventory are clearly short-term, while land, buildings, furniture and most equipment are to be used for longer periods. What kind of asset is a storage warehouse? (current asset) (fixed asset)

2. Right. Land, buildings, furniture and fixtures, and machinery and equipment make up most fixed, or capital, assets. Land and buildings are called "real" property. This word comes from "royal" since the king once owned the land rights. Furniture or equipment is called "personal" property, or "personalty" to distinguish it from real property, even though it may belong to a company, and not an individual person. A company is often considered a "person" for legal purposes.

3. Another way of classifying assets besides current and fixed, real and personal, is "tangible" and "intangible". Tangible usually means touchable, so inventory, land, building and equipment are tangible. Intangible assets might include accounts receivable, but the term is generally applied to property like patents, copyrights, leases, franchises and "goodwill". Does intangible always mean worthless? (Yes) (No)

4. Right. But intangibles like patents and franchises, although valuable,usually are less readily marketable than most current assets. How would you classify a typewriter? (personalty, tangible asset, fixed asset) (short-term, copyright, leasehold) (real property, intangible, current asset)

5. Yes. Of course anything, even real property or equipment, is a current asset to someone who is a dealer in it, and expects to sell it soon. But fixed assets which are held to help serve the main business of a firm are recorded in a special way so their gradual depreciation, or reduction in value, is charged as an expense. What is another name for such long-term property used in the business? (buried assets) (plant assets) (rooted assets)

6. Oil, gas, ore and timber are called "natural resources" and are often classified as "wasting assets" subject to "depletion" as the oil or gas is removed. Other assets are "deferred expenses" or "costs", which are reduced or "amortized" over a number of years.

7. Stocks, bonds and term notes may be either short or long-term assets, depending on the available market for them and the intentions of the firm. They will probably be separately classified as "investments".

8. When a fixed asset is bought, it should be recorded at the toal price including all cost such as fees, commissions, freight, installation and so on, but less any discounts. Interest on funds used during building construction is sometimes included, but interest on long-term loans to pay for ownership is a financial cost, which must be expensed. The "book" value of buildings is gradually

reduced by depreciation, but would you think the value of the land is depreciated? (Yes, always) (Generally not)

9. If you bought some land with an old building on it for $20,000, and paid $2,000 more to wreck and remove the building; then $1,000 for a survey, real-estate-agent help and land leveling; how much of an asset value would be debited to the real-estate account? ($20,000) ($21,000) ($23,000)

10. Right. And land doesn't depreciate in value, while buildings are usually written off in 20 to 40 years, and equipment in 5 to 10 years. A long-term asset depreciates because it either wears out, becomes obsolete or inadequate, or begins to require excessive maintenance. A soundly-built general-purpose building retains its value for a long time, but even a good computer or calculator soon is worth less, as newer and better models become available.

11. If a building cost $25,000 and is expected to last 25 years, you might charge depreciation expense $1,000 per year. This is called "straightline" depreciation. But other factors and procedures can be considered. If a small computer cost $6,000 and had a useful life of 5 years, but could then be sold as salvage for $1,000; instead of depreciating at $1,000 per year, you could depreciate it more the first year and less the fifth year. How would you describe these last factors? (allowance for salvage, variable rate depreciation) (expensive allowance, fixed depreciation)

12. Yes. In addition to depreciating a fixed asset a constant amount, there are two widely-used procedures for increased depreciation in early years, and reduced amounts later. This idea is called "accelerated depreciation", and the two methods are referred to as "declining balance" and "sum-of-the-digits" methods. What is another name for constant depreciation? (crooked) (straight-line) (curved)

13. The declining balance method charges a larger percentage, often 20% to 40% of the remaining value, each year to depreciation expense, but since the remaining value is reduced each year, depreciation which begins at a greater amount eventually becomes smaller. A $6,000 computer might be depreciated 30% of the depreciated balance each year, which could provide $1,800 depreciation the first year, but only $432 by the fifth year.

14. The "sum-of-the-digits" or "sum-of-the-years-digits" system employs an arithmetic trick to vary the rate. If the period selected is say, 5 years, the numbers one through five are added, giving 15, then the proportion to be depreciated is obtained by reversing the digits, giving 5/15 depreciation the first year, 4/15 the second, and so on to 1/15 during the fifth year.

15. With the straight-line and the sum-of-the-digits methods, a salvage value of 10 to 20% of the original is often selected, and the balance, the depreciable value, is depreciated. But since the declining balance method never goes to zero, a separate salvage value is often not specified.

16. Here are the depreciated balances of a $6,000 asset depreciated over 5 years with $1,000 salvage value using straight-line and sum-of-the-digits methods, as well as a 30% per year overall

declining balance method. Which method provides the greatest first-year depreciation? (straight-line) (declining balance) (sum-of-the-digits)

17. Yes. The rates were selected to give about the same value at the end of the five years. Which method has the lowest depreciation in the fifth year? (straight-line) (declining balance) (sum-of-the-digits)

18. Yes. There are ways to calculate the percentage of depreciation on the declining balance which will result in a selected salvage balance in a certain number of years, but most often the "double-declining balance" means that you use twice the straight-line rate: If the life is five years, instead of a straight-line 20%, use 40% of the declining balance. If the life is 10 years, instead of 10% of the original sum, use 20% of the declining balance.

19. One of the features of straight-line depreciation is its simple, constant value. What are some of the features of the variable-rate methods? (closer to market value, increase early expenses, so defers taxes) (unrelated to market value, increases earlier profit)

20. Yes. The more rapid early depreciation methods probably more closely reflect the real market value of the asset, and by increasing the non-cash expense of depreciation, the early cash outlay for income tax is reduced.

21. There are other methods for calculating depreciation, including the calculation of unit output. If a machine is rated to perform a million operations, expected to occur in 10 years, perhaps it should be half-depreciated at a half-million operations even if this occurs in only 3 years.

22. Natural resources may be written down or written off in the same way, when geologists report that 25%, or half, or some other portion of the available oil, gas, or minerals have been depleted. Which would be most important in calculating the reduction of natural resource assets? (elapsed time) (resources removed) (years allowed)

23. Yes. On the other hand, it is normally impossible to assign a unit cost to the reduction of of intangible assets such as patents and copyrights, unless the lifetime unit sales can be predicted. Patents are granted for 17 years, and if patent rights are purchased 10 years before expiration, it is customary to "amortize" the cost at a constant rate, in this case at 10%per year.

24. Royalties for mineral rights or copyrights may have estimated total unit lives, or may be written down at a constant or variable rate per year. What is the term for reducton of <u>intangible</u> assets? (amortize) (depreciation) (depletion)

25. Yes. A copyright, which protects artistic and literary work for 28 years, may be renewed for 28 more years. How long does a patent last? (7 years) (17 years) (27 years)

26. Another possible intangible asset is "Organization Costs" which may be listed as a "deferred expense" asset and amortized over several years. For corporations, this includes legal and incorporation fees and the like which might be better charged off over, say, five years rather than just the first year.

27. "Goodwill" is an intangible asset which arises when a company buys all or part of another firm for more than the value of its identifiable assets. This is often done because the firm is making unusually high profits and should continue to do so. How could you define "goodwill"? (difference between appraised value, and a higher price paid for extra earning potential) (the appraised value of the publicity about a good merger)

28. Yes. Most companies perform some product or process research and development every year. But at times some companies may devote substantial funds to developments which are out of the ordinary, and the actual cost of this intellectual property, whether evidenced by patents and copyrights or not, may be held as an asset, called "Deferred" or "Capitalized Research and Development". This asset is then amortized according to some schedule.

29. Ordinary repair and maintenance expenses for capital facilities are considered routine expenses, and are charged against current operations. Sometimes a substantial expenditure is made to materially improve some equipment or structure for productive purposes. This may be called a "capital expenditure" and retained as an asset to be slowly expensed as depreciation. How could you describe such capital improvements? (tangible assets) (intangible assets)

30. Sometimes the improvements or renovations of existing facilities will extend their useful life. In this case the cost of improvements is added to the undepreciated balance of the original asset and a new longer-term depreciation schedule is set up.

31. Unlike the "One-Hoss Shay", equipment and buildings don't fall apart when their predicted lifetime expires. Some facilities are worn out before then, but many are still useful after they are fully depreciated. When this happens the assets are still shown on the books at zero or scrap value, but no further depreciation expense is charged.

32. Whenever an asset become less valuable in use to the company than its market value as a used facility, it will normally be sold, whatever the remaining book value. This may mean a nominal profit or loss in selling it. How would you enter such a profitable sale? (Debit: Accumulated Depreciation $..., Debit: Cash $..., Credit: Equipment[asset] $..., Credit: Gain on Sale of Equipment $...) (Debit: Equipment $..., Credit: Cash $...)

33. Some assets, especially automotive, are traded in on new units instead of being junked or sold. If the trade-in allowance is greater than the remaining book value, a gain may be entered, but often this is not done and the new asset is merely entered at a lower than usual cost; the total of the price difference paid plus remaining book value.

34. If an asset has been fully depreciated to a nominal scrap value, but there is no purchaser and it must be hauled off as valueless junk, what entry is made? (Debit: Loss on Equipment $..., Credit: Equipment [asset] $...) (Debit: Equipment [asset] $..., Credit: Equipment [liability] $..., Debit: Gain on Equipment $..., Credit: Accounts Payable $...)

35. There are often conflicting motives in establishing depreciation, amortization and depletion

schedules, or in taking profits or losses from disposition of assets. There is always the desire to minimize or defer the payment of income taxes by showing losses early, but it is also often desirable to indicate real profits by showing extra income or lower expenses.

36. Accepted accounting practices allow a wide variation in the choices of accounting for long-term assets. Accountants are required to apply educated and experienced judgement to such decisions while attempting to meet the legitimate objectives of company management.

37. A small company may establish a general ledger account for each fixed asset, but a larger company with many fixed assets will use a control account for a subsidiary ledger listing these assets. They are often listed on separate cards in a long-term asset record file, each card listing a description, date acquired, salvage value, depreciation rate and method.

38. In 1977, a computer purchased five years earlier which had been fully depreciated to an estimated salvage value of $1000 was traded in for a newer, smaller, better computer. Only $500 trade-in value way allowed. What was one of the entries required? (Debit: Cash) (Debit: Loss on sale of asset) (Credit: Gain on purchase)

39. In 1974, a fixed asset account was depreciated $1,000 and in 1975 and 1976 the same assets were depreciated $900 and $810. Which method was being used? (straight-line) (declining balance) (sum-of-the-digits)

40. Depreciation, amortization and depletion of long term assets should be carefully managed, for although they are not cash expenses, they are real expenses, and they have important effects on company operations, condition, and tax liability. You should repeat this program to learn it well.

Proprietors, Partners and Corporations

1. A lot of people would like to own their own business, but most work for someone else. This is because most goods and services are more efficiently produced by organizations with at least several employees. But some kinds of businesses, especially those providing legal, medical and other professional services, are often owned by one person. A firm owned by one person is called a proprietorship.

2. Two or more persons may jointly own a business by means of a formal or informal agreement in which they make contributions of capital and services and receive an agreed proportion of the business earnings. This form of business organization is called a partnership. What is the name of a simple business organization with one owner? (proprietorship) (partnership) (corporation)

3. Yes. The third major form of business organization is established by the act of a state in issuing a corporate charter which forms a new legal 'person,' which can be owned by many persons who can more freely buy shares in it. This form is called a corporation. What is a another form of business which can be owned by two or more persons? (proprietorship) (partnership) (corporation)

4. Yes. In each form of business organization the owners can claim only the excess of the assets over the liabilities, called the 'equity,' or sometimes the 'capital.' Which form is established by the issue of a state charter which, under restrictions, permits the sale of shares? (proprietorship) (partnership) (corporation)

5. Right. While it is true that proprietorships are usually smaller service or merchandising firms, partnerships are typically professional firms and corporations are often large manufacturing firms, there are many examples of large proprietorships in manufacturing, and tiny corporations in service or merchandising. The reasons for choosing one form or another are related to their advantages and disadvantages.

6. A single proprietorship is simple to organize, allows the owner freedom of initiative and incentive to work hard, and requires fewer records and government reports. Unfortunately the proprietor's capital and credit may be limited, and he or she is personally responsible for all the liabilities of the firm.

7. A partnership brings into the firm the greater personal ability and experience or two or more owners, as well as added capital. Since each partner is liable for debts of the partnership, lines of credit are greater. Unfortunately, this potentioal liability of each partner for all debts increases personal risks. Also partners can't easily transfer their ownership in the firm. Which form of organization is the simplest to organize? (proprietorship) (partnership) (corporation)

8. Yes. A corporation usually isolates the owners who are shareholders from its debts. Shares of ownership are more easily transferred, and the death or resignation of a shareholder or manager

does not end the life of the corporation. Which business form may have a greater risk of personal liability? (proprietorship) (partnership) (corporation)

9. Yes. Unfortunately for corporations, their earnings are at present subject to double taxation, since the corporation must pay federal and often state income tax, then shareholders must pay ordinary (the highest) personal income tax on company earnings which are distributed to them as dividends. Which business form eliminates the extra personal liability of its owners? (proprietorship) (partnership) (corporation)

10. Right. A typical proprietorship is a small store or personal service establishment. The owner opens bookkeeping accounts by listing all assets and liabilities considered to be put into the business. A bank account is opened for the business. If employees are to be hired, a Social Security account is set up. Business licenses and fees may be paid, and so on.

11. While many proprietorships are set up just by investment of cash, they commonly begin by including cash and other assets, some of which are subject to debt claims. The difference between the total of cash and other assets and the total of liabilities is the equity, and is first entered for example as the 'John Smith, Capital' account.

12. Soon entries are made in a 'John Smith, Personal Drawing' account and in the various Revenue and Expense accounts, which are considered 'temporary equity' accounts. A 'Cost of Goods Sold' account is also included for merchandising and manufacturing firms. What are some typical first accounts for small proprietorships? (cash, notes payable, equipment, capital) (bookings, bankrolls, bonds, benefits)

13. At the end of each year or other accounting period, the revenue and expense temporary equity accounts of a proprietorship are closed out, and in the case of a merchandising firm, the 'Cost of Goods Sold' account is debited for net purchases and beginning inventory, and credited for ending inventory. The profit if any from revenues after 'Cost of Goods Sold' and expenses, is added to capital. The Personal Drawing total is subtracted from capital.

14. In general, the assets, liabilities, revenues and expenses are recorded similiarly for all forms of business organizations. Only the Capital, or equity, accounts are different. Proprietorships provide for the owner drawing account in part as a substitute for an allowance for owner salary, and partly for withdrawal of capital, whether from original investment or of accumulated earnings.

15. Partnerships of the usual kind are like proprietorships in that owners are personally liable for debts of the firm. And like corporations, the ownership of the firm by each partner is based on his investment, as modified by an agreement. Such Articles of Partnership indicate the date, names of partners, kind of business, duration, title, place, investments, shares of profits, salaries, restrictions and dissolution provisions. How are accounts kept for partnerships? (generally the same as other forms of business, except for equity) (Quite unique. Has no liabilities, but confined to capital assets)

16. Yes. The equity arrangement of partnerships resembles proprietorships in that the death or retirement of a partner ends the partnership, and the partners are liable for the firm's debts. But this is not always true, since some states allow certain partners to have limited liability if other, 'general' partners assume full liability.

17. Partners, unlike corporate shareholders, can't sell and transfer their interest in a partnership without the consent of the other partners. How are the partnership terms established? (by flipping a coin) (In Articles of Partnerships, with date, names, salaries, limitations, dissolution provisions)

18. Right. When partnerships are established, the value of the investment made by each partner is noted, and the share of ownership in the firm is established by agreement, usually at the ratio of each investment. The share of earnings which each partner is allowed, however, may not be the same as the respective share of investment, since different partners may bring in an existing business which is better or worse than the other business, or may work full or part time.

19. John Brown is a young lawyer who has a number of good clients and $5000 worth of furnishings and equipment. He plans to join the firm of Black, Grey and White, well-known attorneys, as a junior partner, receiving 10% of the firm's income, but not assuming full liability. Can this be done in a partnership? (Yes, in some states, with a limited partnership) (No)

20. Partners may allocate themselves fixed monthly drawing amounts, then once or twice a year may allocate the profits or losses, usually in the same proportions as the drawing amounts. In a partnership, does the firm, as well as each of the partners, pay income taxes? (Yes, always) (Generally not)

21. Right. But if the firm were a corporation, it would pay income taxes on any profits it made after payment of salaries to all of its employees but before payment of dividends to its owners. And its principal employees could join or leave the firm with no requirement for a change in the corporate charter.

22. During the past century, the advantage of easier purchase and sale of shares of ownership in a corporation has made this form of business organization popular for larger firms which sought capital from individuals who took no part in the company's operations. During boom times the market trading price of shares was often substantially greater than their net asset value, implying hopes of rapid growth of earning.

23. In the 1970's, however, the shares of many corporations have sold for materially less than proportional net asset value, partly due to business conditions, and perhaps due to the gradual realization that the double payment of income taxes by both corporation and individual shareholder cannot be overcome. What is a principal advantage of corporations? (Ownership shares are easily sold and transferred.) (Corporations can avoid all income taxes.)

24. A profit-seeking corporation owned by private individuals is considered a "person" for legal purposes, and its owners do not have responsibility for its debts, although they may lose their original investment. When a new corporation is formed and cash investments are made, assets are thus established. Where will new investment of shareholders be shown? (assets) (liabilities) (equity)

25. A corporation charter lists its name, which must be new and unique; its purpose, which may be broadly stated; its general location and duration, which may be 99 years or in perpetuity; the incorporators and first directors and the number of authorized shares and their nominal value. The charter may be changed later by shareholder consent.

26. Each of the 50 states in the U.S. has laws permitting the charter of corporations, but larger national companies often incorporate in Delaware, which has convenient provisions. Three individuals are required as incorporators, but often only one owns shares. Moderate filing fees are required; property other than cash received for shares must be described. How do you think the ownership of a corporation is indicated and certified? (by greenbacks issued for each $100 in cash invested) (by certificates for shares of capital stock issued to shareowners)

27. Right. Potential shareholders may subscribe for shares, that is, promise to buy them. Shares are called stock, and the owners are usually called stockholders. Certificates for shares of stock are somwhat like bank checks in that they can be issued for any number of shares.

28. Stockholders vote for corporate directors, with each share counting one vote. Corporate directors are members of the Board of Directors of the corporation and have very wide legal powers to control it. They may select a few director to be on a smaller Executive Committee of the Board with important delegated powers.

29. Shareholders meet at least once per year in person or by proxy, which means by written instruction, to vote on basic matters and elect directors. The Board of Directors meets at least once, and usually several times, per year. It elects the officers, including its chairman, the president, vice presidents, corporate secretary and treasurer. How are shareholders' votes weighted? (One vote per share) (One vote per shareholder)

30. Officers and directors are not personally liable for the debts of the corporation, but they are liable for their actions if they are fraudulent or otherwise illegal, and they are responsible to the shareholders for successful operation of the company, or they will be replaced.

31. The directors may authorize the officers to sell shares, not exceeding the number authorized by shareholders, under terms and at prices which may be specified. Each share may have a stated or "par value", often only a nominal amount such as ten cents, below which they may not be sold by the company. Sometimes shares have no par value given. Who elects the corporate president? (the shareholders) (the Board of Directors) (the Chairman)

32. The basic type of shares issued by corporations is called 'common stock.' It allows its owners to vote, and to receive distribution of profits called 'dividends.' But there are other kinds of stock--'class A, 'class B,' 'nonvoting,' 'preferred' and so on, which are less often issued. Preferred stock has prior claim on earnings to common stock, but is not a liability or debt of the company, since it is part of capital.

33. Bonds are debts of the company, like notes, so they are carried with the company's liabilities. Which are the basic kind of voting capital shares? (common stock) (preferred stock) (private stock)

34. The permanent equity accounts of a corporation are slightly different from those of a proprietorship or partnership since the equity due to earnings, and sometimes the equity due to shares sold in excess of par value, are listed separately from basic capital. The balance sheet may list 'Capital,' 'Additional Paid-in-Capital' and 'Retained Earnings' (or Deficit).

35. On those temporary occasions when funds are due to be received into or paid out of equity as a result of subscriptions to buy stock or decision to pay dividends, the equity accounts are increased or decreased at the same time that an offsetting asset 'Subscription Receivable,' or liability 'Dividends Payable' is entered, until the funds are actually received or paid.

36. Like other transactions, every equity transaction between company and shareholders must have at least two effects. As in regular business operation, the accountant must analyze the effect of each transaction in order to determine the accounts which will be affected. But are the accounts of the corporation affected when one shareholder sells some already outstanding shares to another shareholder? (Yes, by the amount of the sale) (No, although the transfer of ownership may be recorded)

37. A corporation may have one million shares authorized by the shareholders and only 200,000 shares owned by shareholders. The 200,000 shares are described as 'issued and outstanding;' the one million shares are called 'authorized,' so the balance of 800,000 shares are termed 'authorized but 'unissued.'

38. There are three ways to value the stock of a corporation. One is the result of legal custom, one is based on accounting, and one is subject to the opinions of investors. What do you think they are? (charter value, account value, option value) (par value, book value, market value)

39. Right. Par value, if one is given, is only a stated nominal value for the shares, while book value is the net assets, or assets less liabilities, of the company divided by the outstanding shares. The market value is the price which might be willingly paid at any time for some of the corporation's shares, and may not be closely related to the book value.

40. There are many special variations of proprietorships, partnerships and corporations which have been made in an attempt to obtain the advantages of each form of business organization while reducing some of its disadvantages. An accountant would be wise to review current publications for the effects of new laws and procedures on these organizational forms.

Yearend Accounting

1. Management require periodic reports as a basis for ongoing evaluation of operations, and for special measures, if necessary. Some reports, like cash, sales and certain inventory, are required daily, weekly and monthly; but for external purposes as well as internal, a full and complete set of reports is required at least once a year.

2. Most government and credit agencies ask for yearend reports, plus significant interim reports, but they will accept reports for fiscal years which end at any convenient time of the year for the organization. If accounts are kept in good order, if posting is kept reasonably current, and if the basis for closing adjustments is well understood, it is not difficult to assemble these figures so that yearend statements can be prepared.

3. Unless a computer is used, a "Work Sheet" is prepared to assemble and present the data which will be used for the yearend reports. A 10- or 12- column work sheet is useful. What reports will be finally generated by this process? (Income Statement, Balance Sheet) (Trial Balance, Inventory Tally)

4. Yes. We will assume first that the trial balances of all the accounts in the various general and subsidiary ledgers were taken and balanced, with all of the steps required to correct any errors. The work sheet is then set up with firm name, title, period and date. Headings are written for each of the 5 or 6 pairs of columns, including debit and credit columns for Trial Balance, Adjustments, Adjusted Trial Balance, Income Statement and Balance Sheet.

5. All of the account titles and numbers in the Chart of Accounts are listed on the Work Sheet, even if they have no balance, since they may require an adjustment. Some accounts, like Cost of Goods sold, should be allowed more than one line, to provide space for several entries. What are typical column-pair heading for the yearend Work Sheet? (General Ledger, Subsidiary Ledger, General Journal) (Date, Time, Profit, Loss) (Trial Balance Adjustments, Adjusted Trial Balance, Income Statement, Balance Sheet)

6. Right. The reason for multiple entries in the Cost of Goods Sold amount Columns is to collect the amounts of beginning and ending inventories, and purchases, net of discounts and returns. Why would you write an account on the Work Sheet if it had no balance? (to be particular) (it may require an adjustment) (this should not be done)

7. Certain accounts normally require no adjustments and will appear in the Trial Balance, Adjusted Trial Balance and Balance Sheet Columns. Typically these are Cash, including bank accounts and Petty Cash, Equipment, Investments, if any, Notes and Accounts Receivable; and the Accounts, Notes and various Taxes Payable.

8. Some of the asset accounts usually require adjustments at the yearend. One is Inventory. The beginning inventory is shown as a debit, or positive amount on the account, and therefore on the

Trial Balance debit column, but this is removed, or offset, by an entry in the Adjustments Credit column. The ending inventory is entered in the Adjustments debit column. These two adjustments in reverse or their difference, is later entered in what other account in the Adjustments column? (Cost of Goods Sold) (Accounts Receivable)

9. The principal liability accounts such as Accounts Payable, Notes Payable, Salaries and Taxes Payable will not usually require yearend adjustments if they are current and posted. Other liability accounts, such as Accrued Interest Payable, will require ending adjustments.

10. In the same respect, the various depreciation accounts, which are not liabilities but "Contra Asset" accounts, will also receive ending adjustments. What would be typical of such adjustments? (debit: Equipment, credit: Cash) (credit: Accumulated Depreciation - Equipment, credit: Accumulated Depreciation - Auto)

11. Right. In compiling the elements of the Cost of Goods Sold, the amounts of beginning and ending inventories are entered in this account in the Adjustments column as offsetting entries to the Adjustments column entries in Inventory. In addition, adjustments are made be crediting net Purchases and debiting Cost of Goods Sold. In some cases net purchases are obtained by additional entries in Purchases Returns and Purchases Discounts.

12. On the yearend summary Work Sheet, or the equivalent computer print-out, the first pair of columns are the trial balance, the account balances from the ledger. The second pair are adjustments, and the third pair the adjusted trial balance. Which accounts are typically affected by yearend adjustments? (Cash, Investments, Notes Receivable, Accounts Receivable) (Inventory, Supplies, Accumulated Depreciation, Purchases, Cost of Goods Sold) (Accounts Payable, Notes Payable, Taxes Payable)

13. Yes. Of course, the Cost of Goods Sold account, like the various expense accounts, is a temporary equity account which does not appear in the Balance Sheets. But you will recall that, unlike the expenses, it does not have a balance in the original trial balance, since it is first entered in the Adjustments columns, then also appears in the Adjusted Trial Balance and the Income Statement columns.

14. The overall or Summary Work Sheet is often supported by subsidiary work sheets, sometimes related to subsidiary ledgers. For example, operating expenses may be entered in three columns of a single line on the overall work sheet as the total of columns in a special Operating Expenses Work Sheet. What are some accounts you would expect to find on such a special work sheet? (Salary, Travel, Auto, Rent and miscellaneous expenses) (Cash, Receivables, Payables, Purchases) (Capital, Sales, income, assets)

15. Yes. And of course telephone and other utilities, Taxes and miscellaneous expenses. The foregoing would be entered in the Trial Balance debit column of this subsidiary, Operating Expense Work Sheet, while the Adjustments column may have entries from Insurance, Depreciation and Supplies Expense which require period-ending calculations.

16. You may notice that the Operating Expense Work Sheet contains only the Debit balance columns. Why is this? (Credit entries are made in the Journal only) (Debit totals only are carried to overall Work Sheet, which must finally balance)

17. Right. You will recall that in many accrual systems, supplies such as advertising catalogs, office supplies and postage are recorded as assets when purchased, and at yearend the value of the balance on hand in subtracted to obtain the cost of supplies which were used. This is entered as Supplies Expense in the Adjustments column of the Operating Expense Work Sheet.

18. In a somewhat similar way, prepaid insurance premiums are entered as an asset, in this case Prepaid Expense, then at the end of the year a proportional charge is made to Insurance Expense, and a reduction in Prepaid Expense.

19. If an insurance policy were purchased with a one-year premium payment of $500 on June 30, what entries would be made on December 31? (Debit Insurance Expense $250, Credit Prepaid Expense $250) (Debit Prepaid Expense $500, Credit Cash $250)

20. Yes. At the end of the year is an appropriate time for writing off bad debts and writing down the value of inventory. If there is a contra-asset account to Accounts Receivable, called Allowance for Bad Debts, in which some selected percentage of credit sales are entered, this may be then applied to specific bad receivables.

21. The Operating Expenses Work Sheet, since it has only debit columns, cannot be checked by ordinary balancing, but a simple check can be made by adding the first two columns, the Trial Balance and the Adjustments, and checking their totals with the last column, Adjusted Trial Balance, Total. Then where are these totals transferred? (to the Journal) (to the Ledger) (to the Yearend Summary Work Sheet)

22. Right. When a total amount such as the Operating Expenses is brought to the Summary Work Sheet as an Adjustments debit only, there are of course offsetting credits in Adjustments, mainly to asset accounts such as Supplies, Prepaid Insurance and Accumulated Depreciation.

23. The accounts in the original Trial Balance have been previously balanced. On the Summary Work Sheet, the next pair of columns, the Adjustments, must now be balanced, and any errors corrected. The third set of columns, the Adjusted Trial Balance, naturally derives from the first two, and any errors which occur are merely the result of copying omissions or reversals, and can be detected by balancing the totals.

24. At this point it should be noted that if a computer or accounting machine is used, the sort of errors which occur in hand-copied accounting do not occur, but similar Work Sheet printouts may be obtained for study, so knowledge of the traditional processes is useful. What are the last two headings of the Summary Work Sheet? (Income Statement, Balance Sheet) (Trial Balance, Adjustments)

25. Yes. As soon as the appropriate amounts have been brought over to the respective Income Statement and Balance Sheet columns from the Adjusted Trial Balance, the total debits in the Income Statement plus the Balance Sheet debits should of course equal the Adjusted Trial Balance debits, where they came from, and likewise the credits. The totals of debits and credits in each pair of statement columns will probably not balance, but their difference should be the same. The difference is "Net Income", a profit or loss for the period. Now enter this amount, to balance the statement columns.

26. Certain of the special yearend entries are, as you know, called "adjusting and closing" entries. Those entries which are called "closing" do in fact close out all of the balance in certain accounts, including Purchases, Freight, Purchase Returns and the operating expense accounts. When these adjustments are made, original entries to record and explain them are made. Where do you think this is done? (Journal) (Ledger) (Report)

27. Yes. This is called "Journalizing the adjusting entries." This is of course different from the usual procedure of posting ordinary transactions from the Journal to the Ledger, so the posting checks are made at the time of Journal entry. These entries and the other yearend closing accounting work are made days or weeks after the yearend, but how are they dated, if the fiscal year is the same as the calendar year? (June 30) (September 30) (December 31)

28. Right. There are several ways to make closing journal entries, but all of them result in reducing temporary equity accounts to zero and raising or lowering the permanent equity accounts to reflect profit or loss in the period which has ended.

29. The permanent equity account is Capital, including, if a corporation, retained earning or loss. What are some of the temporary equity accounts which are "closed out" by yearend adjustments? (Cash, Accounts Receivable, Accounts Payable) (Revenues, Operating Expenses, Purchases) (Investments, Inventory, Equipment)

30. Yes. Some accounting systems include a "Profit and Loss" or "Income " summary account to combine most of the temporary equity accounts such as revenues and expenses. In the yearend closing Journal entries, the Income Summary is debited and Capital is credited with any profits which were earned during the period.

31. Some firms may, at the end of the year, distribute some of the year's earnings, if any, to the shareholders, partners, or in the case of a proprietorship, to the owner. This is not always a closing or yearend activity, however.

32. The payment of part of the retained earnings of a corporation to shareholders is called a "dividend." Corporate retained earnings are earnings left over after state and federal income taxes of nearly half of income have been paid. Shareholders then must also pay personal income tax on these previously taxed earnings. What would you call payments from earnings to partners and proprietors? (contributions to Capital) (withdrawals) (dividends)

33. Yes. Whether owner, partner, or shareholder payments are made or not, the closing entries finally result in a new permanent Capital amount. When the entries are written into the Journal, the sales or revenue accounts are closed first. Here you see in the Journal under "closing entries," entries for Sales, Interest Earned, and Other Income.

34. The closing entry from the Expense and Revenue Summary may break sales down by departments, or major product lines, or list merchandise and services separately, as well as showing sales returns and discounts separately instead of merely a single entry for net sales.

35. After Revenues, entries for Expenses, usually from the Expense and Revenue Summary, are entered in the Journal. When entered in limited detail, the Cost of Goods Sold will usually show the largest amount. After revenues, and expenses, what closing Journal entries would be made? (Costs) (Cash) (Capital)

36. Right. In order to indicate clearly on the expense and revenue ledger accounts where one year or other period ends and the new year begins, lines are drawn below the lowest entry, whether debit or credit, and the total of debits or credits written. The closing entry brings these account to zero balance. Then heavy double lines are drawn below the toals. This is called "balancing and ruling."

37. In addition to the temporary equity account for revenues and expnese, permanent accounts may also by lined to mark off the end of a fiscal year. What is this process called? (Balancing and ruling) (marking the spot) (alignment of the ledger)

38. In addition to yearly closing and completed reports, similar but less elaborate procedures are employed to provide current information on operations and condition. Such reports are called "Interim Reports."

39. The process of Recording, then adjusting, closing, documenting and reporting the financial data of a firm during, and at the end of an accounting period is often called the "accounting cycle," because it is repeated each year. You will become familiar with its important aspects as you study accounting.

40. Accountants may take summer vacations like everyone but if their organization's fiscal year ends on December 31, January and even February can be months of hard work and overtime. The quicker the reports can be provided to management, the more useful they are. What is this periodically repeating schedule of accounting procedures called? (the bookkeeping merry-go-round) (the accounting cycle)

Computer Accounting

1. You probably have remarked that much of the work involved in bookkeeping and accounting is routine copying of names and numbers, ordinary addition, subtraction, multiplication or division, as well as a certain amount of typing of periodic reports. Once the rules are learned, a lot of accounting may seem rather mechanical.

2. But this is not true of many accounting decisions. Accountants must continually decide whether a transaction is of one type or another. Although some decisions are obvious, other decisions require considerable study, knowledge and experience. So it is quite helpful to have a computer perform the routine, mechanical steps and reduce the chance for human error. Accountants are not afraid of computers; they welcome and use them as tools.

3. Human beings must design a computerized accounting system for a specific organization, which like all organizations, has unique requirements. And humans must examine the original records, source documents, and the actual goods to determine what entries are to be made into the computer. What are some of the original records of transactions? (cancelled checks, stubs, purchase orders, sales receipts, invoices, credit slips) (income statements, balance sheet, annual report)

4. Yes. Some automatic accounting systems are not actually general-purpose computers, but are specifically-designed bookkeeping machines or systems. They all, however, share one feature: the first entry by a bookkeeper or assistant into the main accounting system may be the only entry made by hand, since all subsequent entries, posting, transfers and calculations are then made by the automatic system.

5. Such systems are often called automated. We will just say computer, or data-processing system, and in most cases it is now primarily performed by digital electronics. How many times must a transaction be entered into such a system? (usually just once) (5 times; journal, ledger, balance, report and trial) (exactly twenty-seven times)

6. Yes. If extreme accuracy is required, as in bank transactions, the same entry into the computer system may be made by two different persons, and if there is an error the system will spot it at once, since it is extremely unlikely that two persons will make the same error.

7. Computers can be programmed to detect certain kinds of gross errors or unusual entries, which helps avoid mistakes in the manual entry into the system. What do you think is the principal reason for the use of computer accounting systems? (always reduced cost, never any errors, simpler system; electronics is dandy) (reduced errors, reduced bookkeeping labor, reduced time for reports, increased data available)

8. The use of two operators to put the same transaction input data into the computer is called "verification" of the original recording. This is physically done by comparing two punched cards, or sections of punched paper tape, or by computer check of data in various kinds of magnetic or semiconductor memory.

9. The computer system also may have a program which calls attention to inconsistent results which occur later in its program such as customer overpayment and the like, which may have resulted from an error in original data input. What is the term used to refer to checking data input? (verification) (validation) (versatility)

10. Yes. Computer systems can be said to have five phases in their automatic processing of data. They are input, control, memory, arithmetic and output. Input and output are relatively easy to understand, for they are the phases which relate to human users. Input is usually by manual alpha-numeric, (that's typewriter-like and adding machine-type) keyboards. What would be some forms of output? (teletypewriter, viewing screen, line printout) (cassette, transistor, magnetic core)

11. Yes. For more than 40 years, punched cards like the IBM type have been used as an input format, since they can be handled easily and are a tangible form of record which is both machine-readable and readable by persons. They can be mailed, perforated, detached and collated and reprocessed conveniently. They may serve as invoices, statements, bills and checks.

12. The standard IBM card has 12 rows and 80 columns. The rows are numbered 0 through 9, and there are two unnumbered rows at the top. The columns have small numbers 1 through 80 at the bottom. A print-out of the letter or number represented by the hole pattern in any column is at the top. One hole means a number; two holes, a letter.

13. Eighty letters, digits and spaces are enough for many transactions, but it can hardly keep data on an entire account. For example, you may need the customer, supplier or employee's name, address, account number and billing date, as well as current sales and returns, and old and new account balances. How many rows of numbers are there on an IBM card? (12) (18) (80)

14. Yes. The information on a card is entered by a key-punch device, printed by a tabulator printer, sorted by sorters and calculated by central processors. More recent computing systems make less use of cards; instead, data is entered into magnetic tape or disc, providing instant visual readout from television type cathode ray picture tubes, and "hard copy" from the tele-printers and line printers.

15. The "control" phase of the computer system is where the activities of the memory and arithmetic logic sections are directed, after the data is "input", and before the results are "output". Input data is usally stored at least temporarily in memory, then directed as needed to arithmetic, then eventually released to the output unit. What are some data memory devices? (neurons, synapses) (television, picture tube) (cards, paper tape, magnetic tape and disc)

16. Right. In addition to machine-readable external memory media such as cards and reel tape; magnetic cassettes, cartridges, solid and "floppy" discs can be inserted and removed from computers. Internal, integrated memory made of tiny doughnut-shaped magnetic "cores" and other memory in the form of integrated circuits are used for temporary storage.

17. The arithmetic logic unit does the essential number work of accounting in computer systems. It adds, subtracts, multiplies and divides as it is instructed to do by the program and the controller. In addition, it "compares" to be sure that the addresses or data are the same as, or perhaps greater or lesser than some value. How could a "compare" function be useful? (maintain inventory level, avoid overdrawn checks, limit any value) (multiplies hours times salary rate)

18. Yes. When we refer to "output" devices, we sometimes mentions "displays" as distinct from "hard copy". An eight-digit display on a pocket calculator, or a twenty-line display on a cathode-ray-tube terminal at an airline counter doesn't provide a permanent record.

19. But a sheet of paper or a form which has been typed or printed by a teletypewriter or line printer is permanent. What would such printed records be called? (display) (hard copy)

20. Right. Some printed or typed matter may serve both as a readable hard copy and machine-readable input. For many years bank checks have been printed with magnetic ink symbol numbers at the bottom, identifying the bank, and often the depositor's number, too. The check is passed through a magnetic pickup or detector which senses the width and location of the strokes, which explains why the characters, although recognizable, have such odd shapes.

21. The bank number assigned by the Federal Reserve System for their processors is printed on the left, and the customer account number, if it appears, is on the right. This system is often called MICR. What do you think it stands for? (magnetic-ink character recognition) (marked indicator check record)

22. Yes. Ordinary visible characters (numbers, letters, etc.) as well as special marks can be picked up with certain photcell detectors. Optical Character Recognition (OCR) equipment can automatically "read" numbers and letters if they are clear and well-formed, and with very few error, if they are typed or printed with a special type font.

23. Special marks like these are now being printed on many items of merchandise to identify them, so that by using photocell wands or similar devices their price can be entered into new-type cash registers. A different kind of mark is printed on bulk-mailed envelopes for photocell pickup. What does "OCR" mean? (Optical Character Recognition) (Official Cash Register)

24. The organization you work with may now or in the future use some kind of automatic system to aid in the original recording of transactions, or later sorting and filing. To remain aware of such developments you should occasionally review the literature about this technology.

25. After initial entry into a computer accounting system, transaction data is stored chronologically in computer-type memory, just as in a manual accounting system the transactions are first put into a journal until a convenient time for posting to the accounts. A chronological printout, or a display readout, can be obtained at any time, but is not always necessary.

26. When the transactions are recorded on an external computer memory, such as punched cards

or tape, or magnetic tape or discs, these devices must be carefully stored to avoid excessive moisture or magnetic fields. In a computer accounting system, what takes the place of the journal? (a plastic-bound booklet with yellow pages) (card, tape, etc., memory storage, [printout or display is available])

27. Very large amounts of information can be stored in external computer memory, but to retrieve this memory the tape must be taken from file storage and inserted into the computer system. It is then scanned serially, which even at high speed may take some time. Internal computer memory, however, remains in the computer and any data can be called up in a fraction of a second.

28. Unfortunately the total capacity of internal computer memory is expensive and limited, so it is primarily used for data being currently processed. How would you describe internal computer memory? (integrated, quickly accessible, rather costly) (separate, slow to scan, inexpensive)

29. Computer posting of initially recorded transactions might be accomplished by scanning a reel of tape and recording recent data in internal memory, then moving balances one account at a time to the arithmetic unit where the new amount is added or subtracted, then transferring the new balance back to internal, and eventually to external, memory.

30. Computers are used for more than mere posting, where only addition and subtraction are involved. Payroll checks can be made out automatically, once the regular and overtime hours and the like for individual employees are entered. These hours are multiplied by the proper hourly pay rate, then appropriate percentage or tabulated deductions are made, to obtain net pay.

31. Computers can be arranged, instructed, or "programmed" to make certain test, so that the extensions on invoices, sales slips, statements or tickets can be checked. What sort of processing steps can the computer do? (just adding and subtraction) (multiplication and division only) (a wide range of sequential arithmetic operations, storage, retrieval and display)

32. Right. The output function of a computer system, like the input function, serves to relate the computer to the external world of people and events, and its product may in fact often be quite similar in nature to the input format: tapes, cards, cartridges and sheets of names and numbers.

33. Since large amounts of data are required to be submitted to the various goverments, especially about employee wages and deductions, computer-compatible output format items, especially reels of magnetic tape, are often sent to goverment agencies instead of printed reports by large organizations.

34. By the way, the term "data", meaning known facts or available information, is held to be a plural noun by grammatical purists; they would say "These data show that, etc." instead of "This data shows that, etc." Common usage, we think, permits the use of "data" as a singular collective noun, but you should be aware of the formal usage.

35. While an electromechanical accounting machine must be used in a way which follows fixed procedures, a general purpose computer may be caused to operate in a certain way by instructions which themselves are handled rather like input data; they may be entered into the computer by magnetic tape or disc, then stored in internal memory, subject to change by additional instructions. This stored program is often called "software". What do you think the computer itself is often called? (hardware) (smoothware) (topwear)

36. Computers can make mistakes, but in virtually every case, the cause can be traced to a human error in programming or entering data. Computers are often considered with great respect or even awe, but you should avoid using a computer system as an excuse for delay or procrastination.

37. Even this teaching machine is rarely the cause of problems in learning from its program, which have been produced by people. What are the five phases of computer operation? (verification, data, program, interaction, interface) (input, control, memory, arithmetic, output)

38. Some external data are readable by persons and other kinds are called machine-readable. Which system is both? (mag tape) (MICR) (floppy discs)

39. Each company or other organization which maintains an accounting system is considered unique, and may therefore have a unique computer accounting system, although its major features are common to those of other organizations. In what way are these systems likely to be special? (no assets are listed) (no liabilities are listed) (charts of accounts may have special accounts and titles)

40. In most of the other program in this series you will learn the accounting steps as if they were to be done manually, but in fact your experiences with accounting in the future will very likely include using a computer of some sort. The references to manual accounting are made mostly to provide a simple means of understanding the fundamental principles of accounting.